McGRAW HILL EDUCATION WINNING WE EDGE SERIES

5th EDITION

Revised & Updated

INDIAN ECONOMY

FOR CIVIL SERVICES EXAMINATIONS

RAMESH SINGH

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FIFTH EDITION

About The Author

Ramesh Singh, a Delhi School of Economics alumnus is an **Educational Consultant** with over two decades of experience in providing guidance for an array of competitive and professional examinations. He has authored books in Hindi and English with **McGraw Hill Education, India,** the popular ones being *Indian Economy, Bharatiya Arthavyavastha, Bharat ka Bhugol, Bhaugolik Models, 1000 Plus Questions on Economic and Social Development, 1000 Plus Questions on General Science*. *Contemporary Essays* is another of his forthcoming title.

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To my parents for whom
educated children were better
than hefty bank deposits—they really are
visionaries in human
resource management and
pure applied economics

Preface to the Fifth Edition

The comprehensive revision of this book is in the light of the growing sales and encouraging feedback from the readers. I am indebted to all those who have sent mails, some appreciative, some critical, some constructive. Based on all the suggestions and feedback, I am delighted to place before you the *Fifth Edition* of the book, fully revised and with *three new chapters* that address the concerns of government policy-making.

The Doha Round of the WTO lapsed in December 2012, ending the first and 'most ambitious' organised attempt towards making a 'multilateral' world economic system possible. But the optimists are still hopeful – that the Round may get 'revived' at the next Conference in Bali, December 2014. President Obama's re-election and his focus to revive the US economy, the situation of countries like Greece, France, Ireland, in the Euro zone are some of the other major global economic concerns.

Meanwhile, India is beset with its own economic woes, much of it due to policy paralysis, weak governance and lack of transparent laws and favourable investment climate. It recorded the lowest growth rate of the decade, due to a combination of national and international factors, including a poor monsoon. The new edition has focused on these areas and attempts to provide an analysis of these issues in a lucid manner.

The Three new Chapters included are (i) *Technology-Environment Dilemma; (ii) Sustainability and Climate Change,* and (iii) *Preparing for the Demographic Dividend.* These address contemporary concerns of the economic situation.

The Chapter *Model Answers* to Selected Questions has been revised and updated with *20 more Model Answers* included. This follows long pending demand from our readers.

Chapters like *Inflation & Business Cycle, Financial Market, Banking, Security Market , Tax Structure* and *Public Finance* etc have been revamped.

Some new issues have been included some of which are listed below:

Basel III & Public Sector Banks; Non-Operating Financial Holding Company; Direct Benefit Transfer; Socio-Economic and Caste Census; 12th Plan Monitorable Targets; Base Effect; Sugar Sector Reforms; Energy Pricing; Edible Oil Economy; DMIC Project; e-Biz Project; 14th Finance Commission; Special Category States; ASER-2012; Effective Revenue Deficit; Result-Framework Document; HDR-2012; Chit Fund; Nidhi; VCES; Commodities Transaction Tax; Capital Gains Tax; Investment Allowance; BSESME and EMERGE; Participatory Notes; Angel Investor; RGESS; Corporate Bond; Inflation-Indexed Bond; Gold Exchange Traded Funds; Broad Based Fund; Escrow Account; e-Gold; Menace of Gold Imports; Retrocession; Mezzanine Financing; NORKA; Looking Beyond Doha; The Economy Today: 2013-14; etc.

The book is updated with statistics and data from latest government documents – *India 2013, Economic Survey 2012-13, Union Budget 2013-14* and the *Railway Budget 2013-14.*

As readers may be aware, the new syllabus and pattern for the Civil Services Main Examination was announced in February, 2013. As per the new guidelines, the existing *Indian Economy* becomes

‘Paper- VI’ in the Examination Scheme while it becomes ‘GS- III’ in the General Studies (GS), carrying *250 marks*. Also, Indian Economy has been ‘prefixed’ by *Technology* and ‘suffixed’ by *Biodiversity, Environment, Security and Disaster Management*.

Looking at GS- III, at the outset, it looks to be a major change. But looking carefully, many questions falling into this new ‘domain’ have been already asked in the last one decade. The only change is that now there is a pronounced emphasis on the applications of the basic doctrines and principles of economy. The aspirants should therefore link the syllabus topics with the way it is to be applied on economic situations and issues. This strategy is to be followed while attempting the Main exam from this year onwards. A similar approach applies to the Essay Paper as well.

The connection between ‘technology’ and ‘environment’ need to be explained here. Technology is the tool to economic development, prosperity and creation of wealth. But mindless use of technology puts pressure on the environment and in turn creates concerns on biodiversity, sustainable development etc. Therefore, there arises the need to evolve methods of ‘disaster management’ to minimize the repercussions. Hence there is a definite link between technology, economy, environment, disaster management etc. The new syllabus has integrated these topics in a ‘holistic manner’ and the UPSC expects the aspirants to write answers to questions with this perspective.

On my part, I have added two new chapters to address this issue namely ***‘technology-environment dilemma’*** of the contemporary times and ***‘sustainability and climate change’***. Hopefully, these chapters will give the readers deeper insight into the issue involved and empower them to create their own style of writing answers.

In the new scheme of things, I would always advise the readers to keep writing your own answers on a variety of questions and link them to the everyday issues of policy making. There is no other short-cut to get a good score in the main examination.

I am glad to tell that in this edition, I have added 20 more *Model Answers* to selected questions to serve the above mentioned need.

We hope you find this new edition useful and valuable for your preparation.

Wishing all my *readers* and the *students* ‘Best of Luck!’ for their forthcoming examinations !

www.facebook.com/IndianEconomyMHE

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Preface to the First Edition

I felt my first serious inclination towards writing when my first article was published in the journal *Mainstream* way back in 1988 while pursuing my post graduation studies at the Delhi School of Economics. My interaction with students inside and outside the classroom in 1990–91, when India faced a serious financial crisis, made me realise that there was an immediate need of a book on Indian economy, which could educate the students about the various aspects and challenges of the Indian economy in a simple and lucid manner. It took nearly two decades to fulfil this dream of mine.

The book has been designed to cater to the requirements of the General Studies paper for various Civil Services Examinations (Union as well as the States), and the optional Economics. It would also be useful for graduate and postgraduate courses in Economics of various universities. Adequate and required notes and references have been given after consulting and referring to an array of sources. I have taken care of both the objective as well as the subjective aspects based on my classroom experience of interacting with the students.

I am grateful to Prof. Majid Husain for the inspiration and motivation I got from him to complete this work. I have especially learnt the art and importance of work, punctuality and honesty in a very practical way from him.

Thanks are also due to Mr. Rajesh Kumar Baghel, Mr. Rakesh Kumar, Md. Ishtiaq, and Mr Vikash. I am indebted to my wife, Mrs Ila Singh, for her full support and my two little daughters, Medha and Smiti, for providing the sparkle in an otherwise monotonous work.

Finally, my special thanks to the team from McGraw-Hill, Mr. Biju Kumar: General Manager—Publishing, Mr. Kannath Prakash—Sponsoring Editor, Mr. Abhishek Sharma—Sponsoring Editor, Ms. Anupma Rai—Senior Copy Editor, and Ms. Medha Arora—Junior Manager—Production, who took great pains to finalise the project and complete it in a record time with all the possible expertise.

I welcome from the readers constructive advice, and comments, which could guide me in further revision of this book.

RAMESH SINGH

ABOUT THE CIVIL SERVICES EXAMINATION

The Civil Services examination comprises two successive stages:

(i) Civil Services (Preliminary) Examination (Objective Type) for the selection of candidates for Main Examination; and

(ii) Civil Services (Main) Examination (Written and Interview) for the selection of candidates for the various services and posts.

Scheme and subjects for the Preliminary and Main Examination.

A. PRELIMINARY EXAMINATION

The Examination shall comprise of two compulsory Papers of 200 marks each.

Note :

(i) Both the question papers will be of the objective type (multiple choice questions).

(ii) The question papers will be set both in Hindi and English. However, questions relating to English Language Comprehension skills of Class X level will be tested through passages from English language only without providing Hindi translation thereof in the question paper.

B. MAIN EXAMINATION

The written examination will consist of the following papers:

Qualifying Papers:

Paper A: (One of the Indian Language to be selected by the candidate from the Languages included in the Eighth Schedule to the Constitution). **300 Marks**

Paper B : English **300 Marks**

The papers on Indian Languages and English (Paper A and Paper B) will be of Matriculation or equivalent standard and will be of qualifying nature. The marks obtained in these papers will not be counted for ranking.

Papers to be counted for merit

Paper I: Essay **250 Marks**

Paper II: General Studies–I **250Marks**

(Indian Heritage and Culture, History and Geography of the World and Society)

Paper III: General Studies –II **250 Marks**

(Governance, Constitution, Polity, Social Justice and International relations)

Paper IV: General Studies –III **250 Marks**

(Technology, Economic Development, Bio-diversity, Environment, Security and Disaster Management)

Paper V: General Studies –IV **250 Marks**

(Ethics, Integrity and Aptitude)

Paper VI: Optional Subject – Paper 1 **250 Marks**

Paper VII: Optional Subject – Paper 2 **250 Marks**

Sub Total (Written test): 1750 Marks

Personality Test: 275 Marks

Grand Total: 2025 Marks

Candidates may choose any one of the optional subjects from amongst the list of subjects given below:

List of optional subjects for Main Examination:

(i) Agriculture
(ii) Animal Husbandry and Veterinary Science
(iii) Anthropology
(iv) Botany
(v) Chemistry
(vi) Civil Engineering
(vii) Commerce and Accountancy
(viii) Economics
(ix) Electrical Engineering
(x) Geography
(xi) Geology
(xii) History
(xiii) Law
(xiv) Management
(xv) Mathematics
(xvi) Mechanical Engineering
(xvii) Medical Science
(xviii) Philosophy
(xix) Physics
(xx) Political Science and International Relations
(xxi) Psychology
(xxii) Public Administration
(xxiii) Sociology
(xxiv) Statistics
(xxv) Zoology
(xxvi) Literature of any one of the following

Assamese, Bengali , Bodo, Dogri, Gujarati, Hindi, Kannada, Kashmiri, Konkani, Maithili,

Malayalam, Manipuri, Marathi, Nepali, Oriya, Punjabi, Sanskrit, Santhali, Sindhi, Tamil, Telugu, Urdu and English.

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INTRODUCTION

*Economics is the study of how goods and services are produced, distributed and consumed – as resources are always in short supply – the British economist Lionel Robbins in 1935 described the discipline as 'the science of scarcity'.**

- Economics—the Discipline
- Organising an Economy
- Role of State in an Economy
- Sectors of an Economy
- Types of Economies
- Idea of National Income
- Uniqueness of the Indian Economy

** See David Orrel & Borin Van Loon, 'Introducing Economics: A Graphic Guide', Faber & Faber, London, 2011, p. 3*

ECONOMICS—THE DISCIPLINE

The study of every discipline starts with the process of defining it. Economics is no exception to this. But the challenge of articulating an over-arching definition of any discipline has never been an easy task and at the end one has to be satisfied with a partial definition. Different economists have seen the discipline with differing perspectives and have been coming up with differing definitions—at times a large number of such definitions became either narrow or incomprehensible. But it is quite necessary to come out with a working definition of the subject one intends to study!

Before coming out with our own working definition of the subject, we may cite here two highly acclaimed and internationally established attempts in this direction:

1. Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people.[1a]

As per the definition there are two key ideas in economics—that goods are scarce and that society must use its resources efficiently. Indeed, economics is an important subject because of the fact of scarcity and the desire for efficiency.

Over the last half-century, the study of economics has included such varied topics that the subject serves different purposes to different students of economics. Some study it to make money (basically, most of its students in the developed world do study economics to enrich themselves. But the same is not correct in the case of the developing world. The truth is that here economics has only been read and taught, not applied—if we do a sweeping generalisation). Others study economics to know about poverty, unemployment, human development, shares and debentures, banking norms, prices and their movements, e-commerce, etc. Still others might be studying the discipline to enhance their knowledge of economics!

2. Economics studies how individuals, firms, government, and other organisations within our society make choices and how these choices determine society's use of its resources.[1b]

Human life depends on consumption of various materials which are made up of the resources available on earth. As there is no limit to human wants, we need infinite resources to gratify our needs and wants. But the resources are limited! Now it is upto the individual and humanity at large as to how they try to satisfy their competing needs to get fulfilled by the limited resources. It means we need to make for some choices before we utilise the scarce resources by prioritising some of our needs. In this process, some needs might never get fulfilled. At the same time there might be some needs which may be fulfilled again and again with the available resources.

Economics is the discipline which studies how the individual, a society, a government is making their prioritised choices in the process of using the scarce resources to gratify the various needs and wants of life. Making such choices is an art as well as a science. As time changes the choices change. As space changes human needs change and so modify the choices. After studying and surveying the various choices made by humanity at large in differing time and space, there developed the discipline of economics. As economics is an exercise in the *space-time continuum* and it deals with living human beings it is a very dynamic subject and should only be read in this perspective to have the real feel.

A Working Definition

It is essential to feel the subject one intends to study. The fundamental way of doing this is starting with the definition of the subject. But the definition, at times or better say most of the times becomes, very abstract, jargon-laden and technical. Such a definition might not give a proper feel and understanding of the subject to a person who does not belong to economics. Most of the students of economics face difficulty in making out a complete meaning of the definition. That is why a very *general* and *layman's* definition is needed.

Human beings in their day-to-day lives are busy doing so many things. There are different activities we are involved in throughout our lives. These activities fall under different categories.

Economics studies the economic activities of mankind. Similarly, political, social and administrative activities of mankind are studied by Political Science, Sociology and Public Administration, respectively. That is why these disciplines are broadly categorised as **humanities** as all of them study human activities. There are many more specialised human activities which are studied under many more disciplines.

Which activities of mankind are the ***economic activities?*** The activities which involve profit, loss, livelihood, occupation, wage, employment, etc. all are economic activities. Economics studies all these activities. Today, economics has many branches and studies highly diverse subject matters right at the global, macro and micro levels.

Why some people go for fuel-efficient cars while others go for fuel-guzzling sports cars? Why the poor are poor? Is capitalism doomed to intensify economic inequality? Will the process of globalisation be able to bridge the poor–rich divide and have a universal homogenising impact on the world? Such varied and many more questions fall under the domain of economics. These days we also can see information technology giving a typically new dimension to economics.

Economics and Economy

The relation between economics and the economy, simply saying, is that of theory and practice. While the former is a discipline studying economic behaviour of human beings, the latter is a still-frame picture of it. Economics will come out with theories of market, employment, etc. and an economy is the real picture of the things which emerge after the follow-up to the same theories in certain areas.

Economy is economics at play in a certain region. This region is best defined today as a country, a nation—the Indian Economy, the Russian Economy, the French Economy, etc. Economy as such means nothing. It gets meaning once it is preceded by the name of a country, a region, a block, etc. When we say developed economies, we mean economies of the developed countries.

Countries of the world might be facing some common economic challenges. At the same time, they might be facing some highly specific challenges. Economists, during the period of evolution of economics, have suggested some fixed number of theories and methods of solving those economic challenges. Now it depends upon the choice of the countries as to which set of principles and theories they select for solving their economic challenges. Now many countries selecting same remedy and tools to fight the same problems might have similar or dissimilar results during a given period. At the same time, two economies selecting different tools to solve the same economic problems might experience the same results or completely different results. Why this is so?

Basically, economic theories are expectations of human behaviour about their economic activities and as human behaviour depends greatly on many internal and external factors, the results are likely to show diversities. The level and quality of natural resources, the quantity and quality of human resources, the socio-political milieu, the historical background, the psychic make of the human resource, etc. are some of the factors which individually as well as collectively impact an economy while carrying out economic activities. These things make it highly difficult for economists to say and forecast the kind of impact a particular economic policy will have on a particular economic setting. Ultimately, implementation and delivery system, all play a highly vital role in solving economic challenges in a country, which economists started studying after the 1960s. Therefore, it is correct to say that economics has less diversity than the economies. There will not be any exaggeration if we say that no two economies of the world are exactly the same, though we might classify them into broader terms like developed and developing, agrarian and industrial, etc.

This diversity makes economics a highly interesting discipline. And via the diverse faces of the economies the economists have been able to modify and remodify their ideas on the subject of economics. The evolutionary history of economics is nothing but modifications in the past theories on the basis of contemporary results and experiences of the economies. It is right to say that economics has developed out of real life practices and it is from the practice to theory. As the practices will be having newer dimensions, the theories of economics will also have newer and more imaginative dimensions.

Focus of Economics

What is the real purpose that economics has been trying to serve? What ultimately economists have been trying to articulate? And what has been the focus of economics and the economists since the birth of the discipline?

Though economics today studies a wide range of issues and topics, if we take an overall picture, its essence has been very simple—the betterment of human life on earth. Improving living conditions of the humanity at large has been the real and the ultimate goal of the discipline. In this process, the economists have been articulating a number of theories and propositions as to how an economy may maximise its economic potential and worth. The first and the most famous work in this direction was by the Scottish philosopher-economist, Adam Smith in *The Wealth of Nations* (1776). We trace the origin of the classical school to this work. Similarly, in the following years and centuries many masterpieces were produced by a great many economists who were trying to improvise better ways of maximising the fruits of economic activities. Economics and the economists have common goals, searching for possible alternatives for the betterment of human life.

Challenge of the Economies

The main challenge of any economy is to fulfill the needs of its population. Every population needs to be supplied some **goods** and **services** for its survival and well-being. These goods might include basic needs such as food, shelter, garments, etc. while it might also consist of refrigerators, air conditioners, cars, medicines, computers, etc. Similarly, the services people need may range from healthcare, drinking water supply, education to advanced and highly sophisticated services like

banking, insurance, airways, telephones, internet, etc. As an economy moves on the ladder of development, the process of fulfilling the needs of the population becomes a never-ending phenomenon. As an economy achieves success in supplying one set of goods and services to its population, the population starts demanding another set of goods and services which are of a higher order. And thus goes on the struggle of the economy—solving one challenge and focusing on another. Standard of living of one set of population varies from another depending upon the attempts and the successes of the concerned economies as to which comparative extent they have been able to fulfill the needs of their population.

There are two aspects of this challenge. First, the availability of the goods and services required by the population and second, the presence of the supply network. Every economy has to guarantee required level of goods and services out of its production process at first. For this, proper level of production capacity is built up which requires a particular level of capital formation or investment. From where the investible funds will be managed is altogether a separate question. Whether the investment will come from the government, the domestic private sector or the foreigners? Once these details are cleared and selected as per the socio-economic conditions of the economy, a proper distribution network for the goods and services produced is assured.

Distribution Network Models

In the arena of ***distribution network,*** we have three historically existing models—**state**, **market** and **state–market mix.** In the first kind of distribution system, the state (i.e. the government) takes the sole responsibility of supplying the goods and services required by the population with no payments being done by the consumer—The former Soviet Union and Communist China being the best examples. In the second categorys comes the market mode of distribution which functions on the basis of price mechanism. In this system, goods and services are made available in the market and on the basis of their demand and supply, their prices are determined in the open market and finally they get distributed to the population. This was the distribution system of the capitalist economies—the whole Euro-America till 1930s. The third and the most prevalent mode of distribution developed out of the experiences of the former two systems is the state–market mix. This distribution system has certain goods and services which might be made available to the population freely or at the subsidised prices by the state and some might be supplied by the market for which consumers need to pay. Almost all economies of the world today follow one or the other kinds of distribution system. As the socio-economic composition of the population of an economy changes the mixture of the goods and services to be supplied by the state and the market get redefined in the economies from time to time.

ORGANISING AN ECONOMY

Any one issue which has affected civilised history of mankind the most and has been a contentious issue is as to how the production process in an economy should be organised. Whether the production should be the sole responsibility of the State/Government or should it be left altogether to the private sector? Again, will it be better to carry on production with a joint effort—a mixture of state and private enterprises?

Depending upon the dominant view of the time in a particular country, different forms of production patterns evolved and different economic systems finally came up, providing alternative ways of organising an economy. The three models of economic systems which we see coming up are basically the different stages in the evolutionary process of our experiments which define a better way of organising our economy. We must have a concise overview of this evolutionary process:

1. Capitalistic Economy

The capitalistic form of economy has its origin in the famous work of Adam Smith—*Wealth of Nations* (1776). Adam Smith (1723–1790), the Scottish philosopher-economist professor at Glasgow University whose writings formed the basis of classical economics had stressed certain fine ideas which were to take fancy among some of the western countries and finally capitalism took birth. He raised his voice against the heavy-handed government regulation of commerce and industry of the time which did not allow the economy to tap its full economic worth and reach the level of well-being. Stressing 'division of labour', an environment of 'laissez faire' (non-interference by the government) he proposed that the 'invisible hand' of the 'market forces' (price mechanism) will bring a state of equilibrium to the economy and a general well-being to the countrymen. For such an economy to function for public well-being, he has acknowledged the need of *competition* in the *market*.

Once the USA attained Independence the ideas of Adam Smith were made part of its public policy – just one year after *Wealth of Nations* was published. From here the idea spread to other parts of Euro-America—by 1800 the economic system 'capitalism' was established which was later known by different names—Private Enterprise System, Free Enterprise System, Market Economy.

The decisions of what to produce, how much to produce and at what price to sell are taken by the market, by the private enterprises in this system, with the state having no economic role.

2. State Economy

Rooted in the ideas of historical change proposed by the German philosopher Karl Marx (1818–1883) more specifically, this kind of economic system first came up in the erstwhile USSR after the Bolshevik Revolution (1917) and got its ideal shape in the People's Republic of China (1949). This form of economic system also spread to other countries in Eastern Europe. Here we see two versions of the state economy—in erstwhile USSR known as the *socialist economy* and in pre-1985 China as the *communist economy*. While socialistic economy emphasised the collective ownership of the means of production (property and assets) and it also ascribed a large role to the state in running the economy, communist economy advocated state ownership of all properties including even labour and absolute power to state in running the economy. Though for Marx, Socialism was a transitional stage to Communism, it never did happen in reality.

Basically, this form of economy came in reaction to the prevalent popular economic system of capitalism and proposed just the opposite. The decisions related to production, supply and prices were all suggested to be taken by the state only. Such economies were also known as Centralised Economy, Centrally Planned Economy, Non-market Economy.

The socialist and communist economies used to criticise capitalistic economics of being based on

exploitation. In response, the capitalist economies called them the practioners of 'state capitalism' where the states were the sole exploitators! The communist and anti-communist propagandas resulted in serious intellectual discussions almost upto mid-1980s.

3. Mixed Economy

The belief in the self-correcting quality of the market and the 'invisible hand' of Adam Smith got a major setback in early 20th century during the Great Depression (1929). The impact of the depression spread from the USA to the other economies of western Europe escalating large scale unemployment, downfall in demand and economic activities and lockouts in industrial enterprises. The prevailing Smithonian macro ideas failed to check the crisis. A new approach was needed which came in the famous work, *The General Theory of Employment, Interest and Money* (1936) by the English economist at Cambridge University, John Maynard Keynes (1883–1946).

Keynes questioned the very principles of 'laissez-faire' and the nature of the 'invisible hand'. He even opined that the invisible hand brings equilibirium to the economy but by 'strangulating the poor'. He suggested that prices and wages of the labour are not flexible enough to provide employment to all. It means there will be some people unemployed when the economy will be at its full potential. Ultimately, a fall in demand will be imminent resulting in recession and if unchecked, in depression which happened in 1929. Questioning the limitations of the market mechanism, Keynes suggested *strong government intervention* in the economy. To get the economy out of the depression, he suggested and increase in the government expenditures, discretionary fiscal policy (fiscal deficit, lower interest rates, cheap money supply, etc.) to boost the demand of goods and services as this was the reason behind the depression. As Keynesian policies were followed, the concerned economies were successfully pulled out of the Great Depression.

While Keynes was inquiring into the causes and cures of the Great Depression he questioned the capitalist economic system being practised throughout Euro-America. He suggested the capitalistic order to assimilate the goals of the socialistic economy (economic ideals of the socialists i.e. the ex-USSR). In the capitalist economies of the time, all the basic goods and services were part of the market mechanism i.e. being produced and supplied by the private sector. It meant that almost everything the people required was supplied by the private enterprises via the market which was ultimately an undimensional movement of money and wealth (from the mass of people to the few who controlled the production and supply chain) and the masses were going through the process of pauperisation every day, thereby weakening their purchasing power. In the end, it affected overall demand and culminated in the Great Depression.

As a follow up to the Keynesian advices, many trendsetting economic policies were initiated throughout the capitalist economies. One very important initiative which came out was the government's active role in the economy. The governments started producing and supplying some basic goods and services which are known as 'public goods'. These goods basically intended to guarantee minimum level of nutrition to all, healthcare, sanitation, education, social security, etc. The expenditure on the public goods were incurred on the public exchequer even if it required deficit financing. Starting from 1930s upto 1950s, almost 50 per cent of the GDP in the Euro-America was spent by the governments on the public goods which also become popular as the ***social sector.*** The essential goods and services which were till date being purchased by the people as 'private goods'

were soon made available by the state 'free-of-cost' giving people more spare money to create demand for the goods and services which were part of the market.

The above instance has been cited here to just show the process as to how capitalism redefined itself by including some useful traits of the non-market economy i.e. the state economy. The ***mixed economy*** arrived in this way and the classical capitalistic economy was challenged by it.

On the margins of the developments given above, it is interesting to note the developments in the State Economies of the time. It was **Prof. Oscar Lange (1904–65),** the Polish philosopher, who in 1950s suggested the same thing for the socialist economy as Keynes had for the capitalist. Prof. Lange praised the state economy for many of its good things but also suggested inclusion of some of the good things of the capitalistic economy[2]. He advised the *state economies* to adopt 'market socialism' (the term was coined by him). His suggestions were outrightly rejected by the state economies as such compromises in socialistic economic order were blasphemous at that time (this was ultimately a suggestion towards democracy from dictatorship).

As Keynes has suggested the capitalist economy to move few steps towards socialistic economy, Prof. Lange was asking just the same in the case of the state economies. Democracies are flexible thus they were able to go for an experiment which paid them in coming times. But as the socialist and communist political systems had been stubborn by nature, they did not go for any experiment and thus started moving towards their economic decay.

It was the communist China under the leadership of Mao Tse Tung where the first opinion came against the total state economic control. And the ultimate example of the state economy (i.e., China) started its preparation towards a limited market economy under the political design of dictatorship. In 1985, China announced its 'open door policy', the first experiment in 'market socialism' — Prof. Lange had the last laugh. Other state economies, though caught unprepared, followed the Chinese experiment towards market socialism. However, switch over to market socialism has not been smooth for most of the state economies. The efforts towards market socialism in the Soviet Union, fuelled by the lofty ideas of 'glasnost' (openness) and 'prestroika' (restructuring), resulted in the very *disintegration* of the nation-state. The experts consider it 'a political fallout of an economic mismanagement'. The other state economies experienced major economic breakdowns in their transition phases to market socialism. Basically, for smooth transition to market socialism some prerequisites were required to be put in place aforehand. China was well ahead doing this homework since Mao's time (specially since 1975 onwards) which emerged as a real winner—the ideal type example of state economy getting smoothly (!) metamorphosed into giant market economy.

These two events spanning many decades were nothing but timely and rational selections of economic traits from each other's economic systems and experiences. The world by the late 1980s was having neither a pure example of capitalistic economy nor a pure example of state economy.

There were many states of the world that opted for mixed economy in the post-Second World War periods after coming out of the colonial rule such as India, Malaysia, Indonesia, etc. to name a few. The leadership of these countries could be considered visionaries which was to be proved by mid-1990!

Though at practical levels, the world looked flat for the mixed economy, a formal opinion on the goodness, immediacy and the ultimate viability of the mixed economy was yet to emerge. The first such authoritative opinion, in this direction, came from the World Bank which accepted the goodness

and the need of 'state intervention' in the economy[3]. This was a turning point in the world economic thinking as the World Bank (WB) and the International Monetary Fund (IMF) were the ardent votaries of the virtues of the free market economy.

The concluding consensus emerged with the publication of the World Development Report (1999) titled *Entering the 21st Century* in which the WB said, "Governments play a vital role in development, but there is no simple set of rules that tells them what to do." The WB went on to suggest in this important document that every country should determine the **areas** and the **extent** of the market and the state intervention depending upon its own stage of economic development, socio-political and other historical factors.

The last WB document had basically rejected both of the historically existing economic orders namely the free-market economy and the state economy—which meant Adam Smith and Karl Marx were cancelled and rejected outrightly, that too on the basis of the historical experiences of both the worlds. Rather, the document advocates for the 'mixture' of both the economic orders i.e. the mixed economy. The long-standing ideological dilemma as to whether the market economy or the state economy was the better or the best way of organising the economy was solved for all time to come. The document pin-pointed good things of both the systems and concluded that they don't have the relationship of dichotomy but that of complimentarity. The real issue is not whether to have market or the state but having both of them together makes more sense. Market economy might suit one economy while it might not suit another—due to the different socio-economic conditions of the economies in reference. Similarly, the state economy model might serve one economy but might not serve the other.

The real answer seems going for neither market or state but a judicious combination of both. As the state-market mix depends upon the socio-economic and political conditions of an economy, there can never be a mechanical prototype of the mixed economy which could be applied upon every economy universally. Every economy needs to explore its own mixture of market and state. Again, the same state might need to redefine composition of the state-market mix in the coming times according to its changed socio-eco-political scenario.

The process of economic reforms in India started in 1991. It was infact the search for a new 'state-market mix' while India had been a mixed economy since independence.

After independence, India opted for the mixed economy when the state-market dilemma was at its peak in the world. In the process of organising the economy, some basic and important infrastructural economic responsibilities were taken up by the State/Governments (centre and state) and rest of the economic activities were left to private enterprise i.e. the market. The kind of state-market mix for which India went was thought to be fit for the socio-economic and political conditions of the time. Once the country started the process of economic reforms in early 1990s, the prevailing state-market mix was redefined and a new form of mixed economy began to be practised. As the socioeconomic conditions had changed the state-market mix also changed. The redefined mixed economy for India had a declared favour for the market economy. Many economic roles which were under complete government monopolies were now opened for participation by the private sector. Examples are many—telecommunication, power, roads, oil and natural gas, etc. At the same time, the responsibilities which were till date being shouldered by the state alone and which could be taken up by the state only were given extra emphasis. In this category comes the whole social sector—education, healthcare, drinking water, sanitation, nutrition, social security, etc.

The economic system of India was a mixed economy in pre-1991 years as it is in post-1991 years but the composition of state-market mix has gone for a change. In future, as the socio-economic and political factors will be changing, India will be redefining its mixed economy, accordingly.

The emergence and evolution of the mixed economy was thus able to settle the long-standing debate as to what was the best way to organise an economy. Starting in 1776 with the *Wealth of Nations* of Adam Smith, it continued till we had the World Development Report of 1999 by the WB[4]. The dilemma continued for almost two and a quarter centuries (1776–2000). Today, once the World Trade Organisation (WTO) has taken over the world economy, the brand of the mixed economy it advocates, is more inclined towards the free market economy. But it does not propagate to make the state an economic non-entity i.e., it leaves scope, for greater state intervention in the required areas if need be.

ROLE OF STATE IN AN ECONOMY

The dilemma of searching the ideal way of organising an economy, as it evolved, was also going to solve another riddle. This riddle was the role of the state in an economy.[5] If we look back into the economic history of the world, we see *three* possible roles for the State/Government in the economy:

(i) As a **regulator** of the economic system (where the state takes important economic decisions, announces the required kind of economic policies, takes the sole responsibility to get them implemented and controlling and punishing those who don't oblige to those economic decisions).

(ii) As a producer and/or supplier of the **'private goods and services'** (these include all those goods and services which constitute the part of market and which will be distributed among the needy according to the principles of the market mechanism. Here the state earns profit as a private enterprise).

(iii) As a producer and/or supplier of the **'public goods'** or the **'social goods'** (these include the goods and services which look essential from the social justice and well-being perspective for the people. Education, healthcare, sanitation, drinking water, nutrition, caring for the handicapped and old etc. come under this category. These goods which are generally distributed free of cost at times might reach the beneficiaries at the subsidised prices. The loss incurred by the state in this way is paid out of the public exchequer which means that the whole economy pays for the cause of a few people).

As different economies selected different roles for the state according to their socio-political ideologies, the world had differing ways of organising the economy and had resulted in the different economic systems in the past.

On the issue of regulating the economy there has been no debate, as we see all economic systems being regulated by the state only. But the selection of other two functions of the state in an economy made the real difference. The economy which selected both the roles (ii and iii) for the state under monopoly we called them the state economies. This category of economy had two variants in the socialist economy at least the labour was not owned and exploited by the state unlike the other—the communist economy where labour used to be under complete state control. These economies had

almost no market.

The economic system which left both the roles (ii and iii) as the sole responsibilities of the private sector was called the capitalistic economic system. Here the state had almost no economic role but played a passive role of the regulator.

Mixed economies had at least kept one economic role fixed for them (i.e. iii) while they played the sole role of supplying public goods to the needy people. In some of the mixed economies the state went on to take some of the roles of supplying the private goods (i.e. ii) even by carrying heavy burdens of subsidies.

The WB document—the WDR, 1999 was a judgement on the possible and the suitable roles of state in the economy which suggested a timely shuffling of state's role in the economy as per the socio-economic and political needs of the economy. We may understand the moot question via Keynes for whom the political problem of mankind is to combine three things:

(i) Economic efficiency,
(ii) Social justice, and
(iii) Individual liberty.

In the process of realising the above-mentioned three objectives, an economy cannot go for either allowing only state's role in the economy or only the market's role in the economy. These challenges could only be faced properly once the state and the market both are given a balanced role in an economy—the balance to be defined by its present conditions and the direction of the future desire of the economy. Striking the right balance between the roles of the state and market in the economies came to be known as the process of economic reforms in the post-WTO world.

If we analyse the need of an economy, we see some compulsory roles for the state in it:

(i) If the regulation and control of an economy is left to the private individual or group (i.e. firms) they will be using the regulatory powers to maximise their profits and returns at the cost of others. That is why this role must rest with the state. It looks more logical in the democratic political set-ups, wherein the interest of the largest numbers is being represented in the regulatory provisions.
(ii) The responsibility of producing and distributing private goods to the people could be well handled by the private sector as this is a profit-fetching area. The state should not burden itself with this responsibility as this could be well taken up by the private sector. But in the absence of the proper presence of the private sector in an economy, many countries in the world gave this responsibility also to the state, India being one among them. But as the private sector became capable, in some countries this responsibility was given up by the state in favour of the private sector and better development has been possible in those economies. In this sense India delayed this process while in Indonesia, Malaysia, Thailand and S. Korea the state did give up this responsibility allowing the entry of the private sector.
(iii) The responsibility of producing and supplying the social/public goods to the needy people cannot be left to the private sector as this is a loss-making role. It means, the state will have to take the sole responsibility or may need to expand its role in such areas—as we see in the post-reforms India.

As the private sector becomes capable of playing the proper role in producing and supplying the

private goods, state saves its important human and economic resources which is transferred to take care of the public goods' production and distribution.

Basically, the WB study, the *East Asian Miracle* (1993) recognises the above-given shift of one kind of mixed economy to the another kind of mixed economy—in the case of the Malaysian, Thai and S. Korean economies—taking place since the mid-1960s. Experts believe that this shift could not take place in time in India. And once it started (1991–92) it was too late and this choice was not voluntary but obligatory. The East Asian economies had gone for the same kind of reform process but by their choice.

SECTORS OF AN ECONOMY

Every economy tries to maximise the returns of economic activities in which it is involved. Whatever be the organising principles of an economy, the economic activities are broadly classified into three broad categories which are known as the three sectors[6] of the economy:

(i) Primary Sector

This sector includes all those economic activities where there is the direct use of natural resources as agriculture, forestry, fishing, fuels, metals, minerals, etc. In some of the economies, mining activities are considered a part of secondary sector though we see direct use of natural resources here. Broadly, such economies term their agricultural sector as the primary sector. This is the case in India.

(ii) Secondary Sector

This sector is rightly called the manufacturing sector which uses the produce of the primary sector as its raw materials. Since the manufacturing is done by the industries this sector is also called the industrial sector—bread and biscuits, cakes, automobiles, textiles, etc.

(iii) Tertiary Sector

This sector includes all those economic activities where different 'services' are produced such as education, banking, insurance, transportation, tourism, etc. This sector is also known as the service sector.

TYPES OF ECONOMIES

Depending upon the shares of the particular sectors in the total production of an economy and the ratio of the dependent population on them for their livelihood, economies are given different names, such as:

(i) Agrarian Economy

An economy is called agrarian if the share of its primary sector is 50 per cent or more in the total output (the GDP) of the economy. At the time of independence, India was such an economy. But now it shows the typical symptom of a service economy with primary sector's contribution falling to almost 18 per cent of its total produce while almost 60 per cent of its population depends on the primary sector for its livelihood. Thus, in *monetary terms* India is no more an agrarian economy, the dependency ratio makes it so—India being the first such example in the economic history of the world.

(ii) Industrial Economy

If the secondary sector contributes 50 per cent or more to the total produce value of an economy, it is an industrial economy. Higher the contribution, higher is the level of industrialisation. The western economies who went for early industrialisation earning faster and enough income and developing early were known as developed economies. Most of these economies have crossed this phase once the process of industrialisation saturated.

(iii) Service Economy

The economy whose 50 per cent or more produce value comes from the tertiary sector is known as the service economy. First lot of such economies in the world were the early industrialised economies. The tertiary sector provides livelihood to the largest number of people in such economies. In the last decade (2003-04 to 2012-13), growth has increasingly come from the services sector[*], whose contribution to overall growth of the economy has been 65 per cent, while that of the industry and agriculture sectors has been 27 per cent and 8 per cent respectively.

By the end of the 19th century it was a well-established fact, at least in the western world, that industrial activities were a faster way to earn income in comparison to agrarian activities. The Second World War had established the fact for the whole world—and almost every country started their preparation for the process of industrialisation. As country after country successfully industrialised, a pattern of the population shift from one to another sector was established, which was known as the ***stages of growth*** of an economy.[7] With the intensification of industrialisation, dependency on primary sector for livelihood decreased and dependency on secondary sector increased consistently. Similarly, such economies saw a population shift from the secondary to the tertiary sector—and these were known as the 'post-industrial' societies or the service societies. Almost the whole Euro-America falls under this category—these economies are having over 50 per cent of their total produce value being contributed by their tertiary sectors and over half of the population depends on the sector for their livelihood. Many other countries which started industrialisation in the post-war period did show abberations in this shift of the population and the income—India being one among them.

IDEA OF NATIONAL INCOME

Income is probably the most frequently used term of economics, used by experts and lay masses.

Income level is the most commonly used tool to determine the well-being and happiness of the nations and their citizens. This remains true today also, even if we know that 'income' is not an exhaustive idea to know about the well-being of the society. There has been some reason for such a perception about the concept of income. Basically, when the idea of 'human development' came into being by early 1990s, the concept of the 'human development index' ultimately was heavily dependent on the level of 'income' of individual in a country. Education and life expectancy can only be enhanced once the required amount of 'investment' (expenditure on them) could be mobilised. Thus, somehow, income came to be established as the 'focal point' of 'development/human dvelopment'.

As income of a single person can be measured, it can be measured for a nation and the whole world, although the method of calculating may be a little bit complex in the latter's case. In due course of time, *four ideas/ways* to calculate the income of a nation[8] developed, which are the subject matter of the 'national income accounting'- an area to which the disciplines Commerce and Statistics are closer. These four ways to look upon 'income' of an economy, although different from each other in some way, are the concepts of GDP, NDP, GNP and NNP. All are a form of the national income, but are different from one another. They all say a different story about the income of a nation in their own specific way. Here, we discuss them in a very objective way.

GDP

Gross Domestic Product (GDP) is the value of the all *final* goods and services produced within the boundary of a nation during one year. For India, this calendar year is from 1st April to 31st March.

It will be better to understand the terms used in the concept, *'gross'* means same thing to Economics and Commerce as 'total' means to Mathematics; *'domestic'* means all the economic activities done inside the boundary of the nation/country and by its own capital; *'product'* is word to define 'goods and services' together; and *'final'* means the stage of a product after which there is no known chance of value addition in it.].

The ***different uses*** of the concept GDP are as given below:

(i) Per annum percentage change in it is the 'growth rate' of an economy. For example, if a country has a GDP of Rs. 107 which is 7 rupees higher than the last year, it has a growth rate of 7 per cent. When we use the term 'a growing' economy, it means that the economy is adding up its income i.e. in quantitative terms.

(ii) It is a 'quantitative' concept and its volume/size indicates the 'internal' strength of the economy. But it does not say anything about the 'qualitative' aspects of the produced goods and services by the economy.

(iii) It is used by the IMF/WB in the comaparative analyses of its member nations.

NDP

Net Domestic Product (NDP) is the GDP calculated after adjusting the weight of the value of 'depreciation'. This is, basically, *net form* of the GDP, i.e. GDP minus the total value of the 'wear and tear' (depreciation) that happened in the assets while the goods and services were being produced. Every asset (except human beings) go for depreciation in the process of their uses, which means they 'wear and tear'. The governments of the economies decide and announce the rates by

which assets depreciate (done in India by the Ministry of Commerce and Industry) and a list is published, which is used by the different sections of the economy to determine the real levels of depreciations in different assets. For example, a residential house in India has a rate of 1 per cent per annum depreciation, an electric fan has 10 per cent per annum, etc., calculated in terms of the asset's price. This is ***one way*** how depreciation is used in economics. The ***other way*** it is used in the external sector while the domestic currency floats freely in front of the foreign currencies, If the value of the domestic currency falls following market mechanism in front of a foreign currency, it is the situation of 'depreciation' in the domestic currency, calculated in terms of loss in value of the domestic currency.

Thus, *NDP = GDP – Depreciation.*

This way, NDP of an economy has to be always lower than its GDP for the same year, since there is no way to cut the depreciation to zero. But mankind has achieved too much in this area by the developments such as 'ball-bearing', 'lubricants', etc., all innovated to minimise the levels of depreciation.

The **different uses** of the concept of NDP are as given below:

(a) For domestic use only – to understand the historical situation of the loss due to depreciation to the economy. Also used to understand and analyse the sectoral situation of depreciation in industry and trade in comparative periods.

(b) To show the achievements of the economy in the area of research and development which have tried cutting the levels of depreciation in a historical time period.

However, NDP is not used in comparative economics, i.e., to compare the economies of the world. Why this is so? This is due to different rates of depreciation which is set by the different economies of the world. Rates of depreciation may be based on logic (as it is in the case of houses in India—the cement, bricks, sand and iron rods which are used to build houses in India can sustain it for the coming 100 years, thus the rate of depreciation is fixed at 1 per cent per annum). But it may not be based on logic all the time - for example, upto Feb 2000 the rate of depreciation for the heavy vehicles (vehicles with 6-wheels and above) was 20 per cent while it was done 40 per cent afterwards - to boost the sales of the vehicles. There was no logic in doubling the rate! Basically, depreciation and its rates are used by the modern governments as a tool of economic policy-making also, which is the ***third way*** how depreciation is used in economics.

GNP

Gross National Product (GNP) is the GDP of a country added with its 'income from abroad'. Here, the trans-boundary economic activities of an economy is also taken into account. The items which are counted in the segment 'Income from Abroad' are:

(i) *Trade Balance:* the net outcome at the year end of the total exports and imports of a country may be positive or negative accordingly added with the GDP (in India's case it has always been negative except the three consecutive years 2000-03 when it was positive, due to high levels of 'services sector' export during the years courtsey the booming BPO industry).

(ii) *Interest of External Loans:* the net outcome on the front of the interest payments i.e. balance of the inflow (on the money lend out by the economy) and the outflow (on the money borrowed

by the economy) of the external interests. In India's case it has been always negative as the economy has been a 'net borrower' from the world economies.

(iii) *Private Remittances:* the net outcome of the money which inflows and outflows on account of the 'private transfers' by the Indian nationals working outside India (to India) and the foreign nationals working in India (to their home countries). On this front India has been always a gainer- till early 1990s from the Gulf region (which fell down afterwards in the wake of the heavy country-bound movements of the Indians working there due to the Gulf War) and afterwards from the USA and the European nations. Basically, during the year **2012**, India is projected (as per the IMF) to be ***the highest*** receiver of this fund to the tune of $58 billion (it was the second highest in 2011 at $55 billion, China was the top gainer with $57 billion).

Ultimately, the balance of all the three components of the 'Income from Abroad' segment may turn out to be positive or negative. In India's case it has been always negative (due to heavy outflows on account of trade deficits and interest payments of the foreign loans). It means, the 'Income from Abroad' is subtracted from India's GDP to calculate its GNP.

The normal formula is *GNP = GDP + Income from Abroad.* But it becomes GNP = GDP + (– Income from Abroad) = GDP – Income from Abroad, in the case of India. This means that India's GNP is always lower than its GDP.

The **different uses** of the concept GNP are as given below:

(a) This is the 'national income' according to which the IMF ranks the nations of the world in terms of the volumes – at the Purchasing Power Parity (at PPP). For detailed discussion on the PPP readers may *search for it alphabetically* in the *Chapter- 24.* India is ranked as the ***4th largest economy*** of the world (after the USA, Japan and China)- while as per the nominal/ prevailing exchange rate of rupee India is the ***13th largest economy***.

(b) It is the more exhaustive concept of national income than the GDP as it indicates about the *'quantitative'* as well as the *'qualitative'* aspect of the economy, i.e., the *'internal'* as well as the *'external'* strength of the economy.

(c) It enables us to learn several facts about the production behaviour and pattern of an economy, such as, how much the outside world is dependent on its product and how much it depends on the world for the same (numerically shown by the size and net flow of its 'trade balance'); what is the standard of its human resource in international parlance (shown by the size and the net flow of its 'private remittances'); what position it holds regarding financial support from and to the world economies (shown by the net flow of 'interests' on external lending/borrowing).

NNP

Net National Product (NNP) of an economy is the GNP after deducting the loss due to 'depreciation'. The formula to derive it may be written like:

NNP = GNP – Depreciation

or,

NNP = GDP + Income from Abroad – Depreciation.

The **different uses** of the concept NNP are as given below:

(a) This is the **'National Income' (NI)** of an economy. Though, the GDP, NDP and GNP, all are 'national income' they are not written with capitalised 'N' and 'I'.

(b) This is the *purest form* of the income of a nation.

(c) When we divide NNP by the total population of nation we get the ***'per capita income'*** (PCI) of that nation i.e. 'income per head per year'. A very basic point should be noted here that this is the point where the rates of dipreciation followed by the different nations make a difference. Higher the rates of depreciation lower the PCI of the nation (whatever be the reason for it- logical or artificial as in the case of depreciation being used as a tool of policy-making)! Though, economies are free to fix any rate of depreciation for the different assets the rates fixed by them make difference when the NI of the nations are compared by the international financial institutions like the IMF, WB, ADB, etc.

Cost and Price of National Income

While calculating national income the issues related to 'cost' and 'price' also needs to be decided. Basically, there are two sets of costs and prices –and an economy needs to choose at which of the two costs and two prices it will calculate its national income. Let us understand the confusion and the relevance of this confusion.[9]

(i) *Cost:* Income of an economy i.e. value of its total produced goods and services may be calculated at either the 'factor cost' or the 'market cost'. What is the difference between them? Basically, ***'factor cost'*** is the 'input cost' the producer has to incur in the process of producing something (such as cost of capital i.e. interest on loans, raw materials, labour, rent, power, etc.). This is also termed as *'factory price'* or 'production cost/price'. This is nothing but 'price' of the commodity from the producer's side. While the ***'market cost'*** is derived after adding the indirect taxes to the factor cost of the product, it means the cost at which the goods reach the market i.e. showrooms (these are the Cenvat/central excise and the CST which are paid by the producers to the Central government in India). This is also known as the *'ex-factory price'*. The weight of the state taxes are then added to it, to finally derive the 'market cost'. In general, they are called *'factor price'* and *'market price'* also.

In India, income is calculated at factor cost, and so is the case with most of the developing countries (but among the developed economies it is calculated at the market cost). The reasons are – lack of uniformity in taxes, goods are not printed with their prices, etc. In present time, we see a great degree of tax-related uniformity coming to India to the extent the central taxes are concerned but the state taxes are still neither single nor uniform. Once the GST is implemented this abberation will end. Though for statistical purposes, income at market cost is also released by the Central Statistical Organisation (CSO).

(ii) *Price:* Income can be derived at two prices– constant and current. The difference in the prices at constant and current prices is only that of the *impact of inflation*. Inflation is considered stand still at a year of past (this year of the past is also known as the ***'base year'***) in the case of the constant price while in the current price the present day inflation is added. Current price is, basically, the maximum retail price (MRP) which we see printed on the goods

selling in the market.

As per the new guidelines the *base year* in India has been revised from the 1993-94 to 2004-05 (the data based on the new constant year is presently known as the 'new series' of data) – announced in September, 2010. *India calculates its national income at constant prices*- so is the situation among the developing economies while the developed nations calculate it at the current prices. Though, for the statistical purposes the CSO releases the national income data at the current prices, too. Why? Basically, inflation has been a challenging aspect of policy making in India because of its level (i.e. range in which it dwindles) and stability (how stable it has been). In such situations the growth in the income levels of the population living below the poverty level (BPL) can never be measured accurately (because due to higher inflation the section will show higher income) and the Government will never be able to measure the *real* impact of the poverty alleviation programmes it runs for the population.

Here, one important aspect of the income needs to be understood. Income of a person has three forms – the first form is ***nominal income*** (the wage someone gets in hand per day or per month), the second form is ***real income*** (this is nominal income minus the present day rate of inflation- adjusted in percentage form), and the last one is the ***disposable income*** (the net part of wage one is free to use which is derived after deducting the direct taxes from the real/nominal income, depending upon the need of data). What happens in practice is that while the nominal income might have increased by only 5 per cent, it looks 15 per cent if the inflation is at the 10 per cent level! Unlike India, among the developed nations, inflation has been around 2 per cent for many decades (it means it has been at lower levels and stable, too. This is why the difference between the incomes at constant and current prices among them are narrow and they calculate their national income at current prices. They get more reliable and realistic data of their income).

The latest data of India's National Income, as per the new ***Economic Survey 2012-13***, is as given below:

i. **National Income** *(i.e. NNP)***:** Approximately, Rs. 45.72 lakh crores at Constant Prices and Rs. 73.99 lakh crores at Current Prices (1st Revised Estimates for the 2011-12).

ii. **Per Capita Income** *(PCI)***:** Approximately, Rs. 38,037 at Constant Prices and Rs. 61, 564 at Current Prices (1st Revised Estimates for the 2011-12).

Taxes & National Income

While accounting/calculating national income the taxes, direct taxes and indirect taxes collected by the governments, needs to be considered. In case of India, to the extent the **direct taxes** (individual income tax, corpoarate income tax i.e. the corporate tax, divident tax, interest tax, etc.) are concerned there is no need of adjustment whether the national income is accounted at factor cost or market cost. This is so because at both the 'costs' they have to be the same, besides these taxes are collected at the incomes of the concerned person or group.

But the amount of **indirect taxes** (cenvat, customs, central sales tax, sales tax/vat, state excise, etc.) needs to be taken care of if the national income is accounted at the 'factor cost' (which is the case with India). If the national income is calculated at the factor cost then the corpus of the total indirect taxes needs to be deducted from it. Why so? This is because, they have been added twice – once in

the hands of the people/group who pay them (because they pay for it from their 'disposable income' while puchasing things!) and other in the hands of the governments (as their income receipts). Collection/source of the indirect taxes are the *'disposable income'* (which individuals and companies have with them after paying their direct taxes – from which they do any purchasing and finally, the indirect taxes reach the various governments!). Thus, if the national income is calculated at the factor cost, the formula to seek it will be:

National Income at Factor Cost = NNP at Market Cost – Indirect Taxes

However, if the national income is being derived at the 'market cost' the indirect taxes do not need to be deducted from it. In this case, the governments need not add their income accruing from indirect taxes to the national income either. It means, that the confusion in the case of national income accounting at factor cost is only related with the indirect taxes.

Subsidies & National Income

Similar to the indirect taxes, the various subsidies which are forwarded by the governments need to be adjusted while calculating national income. They are added to the national income at market cost, in case of India[9]. Subsidies are added in the national income at the market cost to derive the national income at factor cost . This is because the price at which the subsidised goods and services are made available by the governments are not their real factor costs (subsidies are forwarded on the factor costs of the goods and services) otherwise we will have a distorted value (which will be less than its real value!). Thus the formula will be:

National Income at Factor Cost = NNP at Market Cost + Subsidies

If the national income is derived at the market cost and governments forward no subsidies there is no need to adjustments for the subsidies – but after all there is not a single economy in the world today which does not forward subsidies in one or the other form.

Putting 'indirect taxes' and the 'subsidies' both together India's National Income will be derived with the following formula (as India does it at the factor cost):

National Income at Factor Cost = NNP at Market Cost – Indirect Taxes + Subsidies

UNIQUENESS OF THE INDIAN ECONOMY

Indian economy did show some traits[10] which were unique:

(i) The contribution of the primary sector in its GDP has fallen down regularly and today it stands at 14.1 per cent—which is sufficient to conclude that it is no more an agrarian economy.

(ii) The share of its tertiary sector increased to over 67.5 per cent in its GDP by 2012–13. This proves India is a service economy.

(iii) The dependency of population on the primary sector for its employment still remains at over 56.8 per cent—a symptom of an agrarian economy. The expansion of the industries was not sufficient to attract the labour force from the primary activities. India is still lagging on this

front badly.

(iv) The share of the secondary sector in its GDP is at 27 per cent and never crossed 40 per cent.

(v) India has been basically the first case which directly had either over 50 per cent of its GDP coming from the primary sector or the tertiary sector—an agrarian economy shifting directly to the service economy (at least partially, if we forget the dependency ratio of the population on the sectors). It means India jumped the stage of being a fully-developed industrial economy!

Without fully realising the industrial and manufacturing potential and directly merging into a service economy, has created tougher macro and micro challenges for policy makers in India.

1a. Samuelson, P.A and Nordhaus, W.D., ***Economics,*** Tata McGraw-Hill Pub. Company Ltd., N. Delhi, 2005, p.4.

1b. Stiglitz, J.E and Walsh, C.E., ***Economics,*** W.W. Norton & Company, New York, 2006, p.6.

2. J.K. Galbraith, ***A History of Economics***, Penguin Books, London, 1991, p. 188–89.

3. ***The East Asian Miracle,*** W.B. Study, 1993.

4. ***World Development Report, 1999,*** World Bank, 1999.

5. A highly concise and to-the-point idea on the issue comes from Joseph. E. Stiglits, ***The Role of Government in Economic Development,*** the keynote address at the *Annual World Bank Conference on Development Economics 1996.*

6. Michael P. Todaro and Stephen C. Smith, ***Economic Development,*** Pearson Education, 8th Ed., N. Delhi, 2004, p. 44.

* Economic Survey 2012-13, MoF, GoI, p.3. .

7. Walt W. Rostow, ***The Stages of Economic Growth: A Non-Communist Manifesto***, Cambridge University Press, London, 1960, pp. 1–

8. The discussion on National Income Accounting is based on several textbooks of Economics and the documents released by the ***International Monetary Fund (IMF)*** and ***World Bank (WB)*** in the area of the ***Comparative Economics*** and the ***International Economics.***

9. The informations on the issues like ‘cost’, ‘price’, ‘taxes’ and ‘subsidies’ are based on the different ***Discussion Papers*** released by the ***Central Statistical Organisation*** (GoI) from time to time.

10. As the informations were made available by the ***Central Statistical Organisation ,*** GoI, N. Delhi; ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi and the ***India 2013,*** Pub. Div., MoIB, GoI, N. Delhi.

2

PROGRESS, GROWTH AND DEVELOPMENT

*Since 1971, Bhutan has rejected GDP as the only way to measure progress – in its place, it has championed a new approach to development, which measures prosperity through formal principles of gross national happiness (GNH) and the spiritual, physical, social and environmental health of its citizens and natural environment. For decades, this belief that wellbeing should take preference over material growth has remained a global oddity. Now, in a world beset by collapsing financial systems, gross inequity and wide-scale environmental destruction, this tiny Buddhist state's approach is attracting a lot of interest. In 2011, the UN adopted Bhutan's call for a holistic approach to development, a move endorsed by 68 countries. A UN panel is now considering ways that Bhutan's GNH model can be replicated across the globe.**

- Progress
- Economic Growth
- Economic Development

* *As Annie Kelly writes in The Guardian, Washington, DC, 1st Dec. 2012.*

PROGRESS

Progress is a general term frequently used by experts to denote betterment or improvement in anything. In economics, the term was used for a long period to show the positive movement in the lives of people and an economy. It had both quantitative and qualitative aspects to it. After a point of time, some economists started using all the three terms—progress, growth and development—interchangeably to mean almost the same thing. But it was only during the three decades of 1960s, 1970s and 1980s that the clear meanings we attach to these terms today, really evolved.[1] The term 'progress' became a general term with no specific meaning in economics or denoting both growth and development. But growth and development were allotted their clear-cut meanings.

ECONOMIC GROWTH

A term coming from the life sciences, 'growth' in economics means economic growth. An increase in the economic variables over a period of time is – economic growth. The term can be used in an individual case or in the case of an economy or for the whole world. The most important aspect of growth is its *quantifiability* i.e. one can measure it in absolute terms.[2] All the units of measurement may be applied to show it, depending upon the economic variable where the growth is being studied. We have a few examples:

(i) An economy might have been able to see growth in its food production during a decade which could be measured in tonnes.

(ii) Road network growth of an economy might be measured for a decade or any period in miles or kilometres.

(iii) Similarly, the value of the total production of an economy might be measured in currency terms which means the economy is growing.

(iv) Per capita income for an economy might be measured in monetary terms over a period.

We may say that ***economic growth is a quantitative progress.***

To calculate the ***growth rate*** of an economic variable the difference between the concerned period is converted into percentage form. For example, if a dairy farm owner produced 100 litres of milk last month and 105 litres in the following month, his dairy has a growth rate of 5 per cent. Similarly, we may calculate the growth rate of an economy for any given successive periods. Growth rate is an ***annual concept*** which may be used otherwise with the clear reference to the period for which it is used.

Though growth is a value neutral term i.e. it might be positive or negative for an economy for a period, we generally use it in the positive sense. If economists say an economy is growing it means the economy is having a positive growth otherwise they use the term '***negative growth***'.

Economic growth is a widely used term in economics which is useful in not only national level economic analyses and policy making but also highly useful in the study of comparative economics. International level financial and commercial institutions go for policy making and future financial planning on the basis of the growth rate data available for the economies of the world.

ECONOMIC DEVELOPMENT

For a comparatively longer period of time after the birth of economics, economists remained focused on the aspects of expanding the quantity of production and income of a country's economy. The main issue economists discussed was—how to increase the quantity of production and income of a kingdom or a nation-state. It was believed that once an economy is able to increase its production its income will also increase and there will be an automatic betterment (quality increase) in the lives of the people of the economy. There was no conscious discussion over the issue of quality expansion in the people's lives. Economic growth was considered as a cause and effect for the betterment of lives of the people. This was the reason why economists till the 1950s failed to distinguish between growth and development though they knew the difference between these terms.

It was during 1960s and in the later decades that economists came across many countries where the growth was comparatively higher but the quality of life was comparatively lower. The time had come to define economic development differently from what the world meant by economic growth. For economists, development indicates the quality of life in the economy which might be seen in accordance with the availability of so many variables such as:

(i) The level of nutrition.
(ii) The expansion and the reach of healthcare facilities—hospitals, medicines, safe drinking water, vaccination, sanitation, etc.
(iii) The level of education among the people.
(iv) There might be many more variables on which the quality of life depends.

Here, one basic thing must be kept in mind that if the masses are to be guaranteed with a basic minimum level of quality–enhancing inputs (above-given variables such as food, health, education, etc.) in their life, a minimum level of income has to be guaranteed for them. Income is generated from productive activities. It means that before assuring development we need to assure growth. Higher economic development requires higher economic growth. But it does not mean that a higher economic growth automatically brings in higher economic development—a confusion the early economists failed to clear. We may cite an example to understand the confusion—two families having same levels of income but spending differing amounts of money on the developmental aspects. One might be giving little attention to health, education and going for saving and the other might not be saving but taking possible care of the issues of health and education. Here the latter necessarily will have higher development in comparison to the former. Thus, we may have some diverse cases of growth and development:

(i) Higher growth and higher development
(ii) Higher growth but lower development
(iii) Lower growth but higher development.

Above-given combinations though, comparative in nature make one thing clear, that, just as for higher income and growth we need conscious efforts, same is true about the economic development and higher economic development. Without a conscious public policy, development has not been possible

anywhere in the world. Similarly, we can say, that without growth there cannot be development either.

The first such instance of growth without development, which the economists saw, was in the Gulf countries. These economies, though they had far higher levels of income and growth, the levels of development there were not of comparable levels. Here then started the branch of economics which will be known as *'development economics'*. After the arrival of the WB and the IMF, conscious economic policies were framed and prescribed for the growth and development of the less-developed economies.

We can say that ***economic development is quantitative as well as qualitative progress*** in an economy.[3] It means, when we use the term growth we mean quantitative progress and when we use the term development we mean quantitative as well as qualitative progress. If economic growth is suitably used for development, it comes back to accelerate the growth and ultimately greater and greater population brought under the arena of development. Similarly, high growth with low development and ill-cared development finally results into fall in growth. Thus, there is a circular relationship between growth and development. This circular relationship broke down when the Great Depression occurred. Once the concept of the *'welfare state'* got established, development became a highly coveted and serious matter of concern for the governments of the world, policy makers and economists, alike. A whole new branch of economics—***welfare economics*** has its origin in the concept of welfare state and the immediacy of development.

Measuring Development

Although economists were able to articulate the differences between growth and development (Mahbub Ul Haq, a leading Pakistani economist had done it by early 1970s itself), it took some more time when the right method of measuring development could be developed. It was an established fact that the goal of progress goes beyond mere 'income increase'. International bodies such as the UNO, IMF and WB all were concerned about the development of the comparatively under developed regions of the world. But any attempt in this direction was only possible once there was a tool to know and measure the developmental level of an economy and the determinants which could be considered the traits of development. The idea of developing a formula/method to measure the development was basically facing two kinds of difficulties:

(i) At one level it was difficult to define as to what constitutes development. Factors which could show development might be many such as level of income/consumption, quality of consumption, healthcare, nutrition, safe drinking water, literacy and education, social security, peaceful community life, availability of social prestige, entertainment, pollution-free environment, etc. It has been a real difficult task to achieve consensus among the experts on these determinants of the development.

(ii) At the second level it looked highly difficult to quantify a concept as development constitutes quantitative as well as qualitative aspects. It is easy to compare qualitative aspects such as beauty, taste, etc. but to measure them we don't have any measuring scale.

Human Development Index

The dilemma was solved once the United Nations Development Programme (UNDP) published its first Human Development Report (HDR) in 1990. The report had a human development index (HDI) which was the first attempt to define and measure the levels of development. The 'index' was a product of selected team of leading scholars, development practioners and members of the Human Development Report office of the UNDP. The first such team which developed the HDI was led by **Mahbub Ul Haq** and **Inge Kaul.** The term 'human development' is a corollary of 'development' in the index.

The HDI went on to select three broad parameters and allotted them an equal weightage on the scale of one and measured the development of the countries included in the report. The three parameters[4] are as given below:

(i) ***Standard of living:*** to be indicated by the real per capita income adjusted for the differing purchasing power parity (PPP).

(ii) ***Knowledge:*** to be measured by indicators related to the level of education:

  (a) educational attainment among the adults (given 2/3rd weightage).

  (b) school enrollment (given 1/3rd weightage).

(iii) ***Life Expectancy:*** to be calculated at the time of birth.

The UNDP ranked[5] the economies in accordance of their achievements on the above-given three parameters on the scale of one (i.e. 0.000–1.000). As per their achievements the countries were broadly classified into three categories with a range of points on the index:

(i) High Human Development Countries: 0.800–1.000 points on the index.

(ii) Medium Human Development Countries: 0.500–0.799 points on the index.

(iii) Low Human Development Countries: 0.000–0.499 points on the index.

The Human Development Report, 2013 is discussed in Chapter 22. together with India's relative position in the world.

The Debate Continues

Though the UNDP commissioned team had evolved a consensus as to what constitutes development, academicians and experts around the world have been debating this issue. By 1995 the economies around the world had officially accepted the concept of human development propounded by the UNDP. Basically, the UNDP designed HDR was used by the World Bank since 1990s to quantify the developmental efforts of the member countries and cheap developmental funds were allocated in accordance. Naturally, the member countries started emphasising on the parameters of income, education and life expectancy in their policy making and in this way the idea of HDI got obligatory or voluntary acceptance around the world.

For many years, experts and scholars came up with their own versions of defining development. They gave unequal weightage to the determinants defining development as well as selected some completely different parameters which could also denote development in a more suitable way according to them. Since quality is a matter of value judgement and a normative concept, such scopes were there. Most of such attempts were not prescriptions for an alternative development index but they were basically trying to show the incompleteness of the HDI, via intellectual satires. One such

attempt was made by the economists and scholars of the London School of Economics in 1999 which concluded Bangladesh as the most developed country in the world with the USA, Norway, Sweden getting one of the lowest ranks in the index!

Basically, it is very much possible to come out with such an index. As for example, we may say that peace of mind is a necessary element of development and betterment in human life which depends heavily on the fact as to how much sleep we get everyday. Housetheft and burglary are major determinants of a good night sleep which in turn depends on the fact as how assured we go to sleep in our homes at night from burglars and thieves. It means we may try to know a good sleep by the data of thefts and burglaries in homes. Since minor housethefts and burglaries are under-reported in police stations, the surveyor, suppose tried to know such cases with data as how much 'locks' were sold in a country in a particular year! In this way a country where people hardly have anything to be stolen or no risk of being burgled might be considered having the best sleep in night, thus the best peace of mind and that is why this will be the most developed country!

Basically, the HDI could be considered as one possible way of measuring development which was evolved by the concerned group of experts with the maximum degree of consensus. But the index which calculates the development of economies on certain parameters might be overlooking many other important factors which affect the development of an economy and standard of living. As per experts, such other determinants affecting our living conditions might be:

(i) Cultural aspects of the economy,

(ii) Outlook towards the aesthetics and purity of the environment,

(iii) Aspects related to the rule and administration in the economy,

(iv) People's idea of happiness and prestige, and

(v) Ethical dimension of human life, etc.

Introspecting Development[6]

Confusion about the real meaning of development did start only after the World Bank and the International Monetary Fund came into being i.e post-war. As experts were studying the development process of the developing world, they were also surveying the performance reports of the developed world. As the western world had been declared the developed countries having top twenty ranks on the HDI, social scientists started evaluating the conditons of life in these economies. Most of such studies concluded that life in the developed world is every thing but happy. Crime, corruption, burglaries, extortion, drug trafficking, flesh trade, rape, homicide, moral degradation, sexual perversion, etc.—all kinds of the so-called vices were thriving in the developed world. It means development had failed to deliver them happiness, peace of mind, a general well-being and a feeling of being in good state. Scholars started questioning the very efforts being made for development around the world. Most of them have suggested a re-defining of development which could deliver happiness to mankind.

Why development has not delivered happiness to the developed world? The answer to this question does not lie in any one objective fact but touches so many areas of human life. First, whenever economists from the outset talked about progress they meant overall happiness of human life.

Social scientists, somehow have been using terms such as progress, growth, development, well-

being, welfare as synonyms of ***'happiness'***. Happiness is a normative concept as well as a state of mind. Therefore its idea might vary from one economy to the other.

Second, the period in which development was defined, it was considered that with the supply of some selected material resources human life can be improved. These resources were pin-pointed as, a better level of income, proper level of nutrition, healthcare facilities, proper levels of literacy and education, etc.

Happiness is a broader thing than development. The so-called 'development' for which the world has been striving hard for last many decades is capable of delivering material happiness to mankind. Happiness has its non-material side also. It means while the world has been trying to maximise its developmental prospects i.e. material happiness, it could not attend the non-material part of happiness. The non-material part of our life is rooted in ethics, religion, spiritualism and cultural values. As development or human development was defined in material terms, it could only deliver us material happiness which is visibly available in the developed world. Due to partial definition of development the developed world has been able to achieve development i.e. happiness but only of material kind and for the non-material part of happiness we, naturally need to redefine our idea of development today or tomorrow!

Somehow a very small kingdom had been able to define development in its own way which included material as well as non-material aspects of life into it and named it the Gross National Happiness (GNH)—it was Bhutan!

Gross National Happiness Bhutan, a small Himalayan kingdom and an economic non-entity developed a new concept of development in early 1970s—the Gross National Happiness (GNH). Without rejecting the idea of human development propounded by the UNDP, the kingdom has been officially following the targets set by the GNH. Bhutan has been following up the GNH since 1972 which has the following parameters to attain happiness/development:

(i) Higher real per capita income.

(ii) Good Governance.

(iii) Environmental Protection.

(iv) Cultural Promotion (i.e. inculcation of *ethical* and *spiritual* values in life without which, it says, progress may become a curse rather than a blessing).

At the level of real per capita income, the GNH and the HDI are the same. Though the HDI is silent on the issue of 'good governance', today it should be considered as being promoted around the world once the World Bank came with its report on it in 1995 and enforced it upon the member states. On the issue of protecting environment though the HDI didn't say anything directly the World Bank and the UNO had already accepted the immediacy of sustainable development by then and by early 1990s there was a seperate UN Convention on the matter (follow up on this convention has been really very low till date which is a different issue).

It means the basic difference between the GNH and the HDI looks at the level of assimilating the ethical and spiritual aspects into our (UNDP's) idea of development.

An impartial analysis sufficiently suggests that material achievements are unable to deliver us happiness devoid of some ethics at its base. And ethics are rooted in the religious and spiritual texts. But the new world is guided by its own scientific and secular interpretation of life and the world has

always been suspicious about recognising the spiritual factor in the human life. Rather the western idea of secularism was defined after rejecting the very existence of anything like God and also rejecting the whole traditional hypothesis of spiritualism as instances of ignorance and orthodoxy. And there should not be any doubt in accepting it that the western ideology in the name of development has ultimately, dominated the modern world and its way of life. The idea of development which was followed by the larger part of the world has been cent per cent 'this-worldly'. And anybody can assess today what kind of happiness the world has been able to have for itself at the end.

A recent study by a senior economist from the UNDP on the Bhutanese development experience under the GNH has vindicated the idea of 'gross happiness' which development must result into. As per the study, the period 1984–98 has been spectacular in terms of development with life expectancy increasing by a hopping 19 years, gross school enrolment reaching 72 per cent and literacy touching 47.5 per cent (from just 17 per cent)[7] .

After the terror attack on the World Trade Centre in the USA the whole world has gone for a psychic metamorphosis and at least euphoria of development from this world to that world has been shaken from its very base. The world which is in the process of globalisation at one hand has started introspecting whether multicultural co-existence is possible. The Human Development Report of 2005 was titled as "Multicultural Co-existence". We may conclude that mankind is passing through a phase of serious introspection and transition where the dominant view in the world may metamorphose into redefining the very idea of development by including ethical values and spiritualism as important parts. But till now the proponents of development look shy in believing and accepting that there exists a non-material part of life too which needs to be realised to make our development result into happiness.

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1. Based on the analyses in Michael P. Todaro and Stephen C. Smith, ***Economic Development,*** Pearson Education, 8th Ed., N. Delhi, 2004, pp. 9–11.
2. As the IMF and the WB considered this yardstick of development as quoted in Gerald M. Meier and James E. Rauch, ***Leading Issues in Economic Development,*** Oxford University Press, N. Delhi, 2006, pp. 12–14.
3. ***World Development Report, 1991,*** World Bank, Oxford University Press, 1991, New York, p. 4.
4. A.P. Thirlwall, ***Growth & Development,*** Palgrave Macmillan, New York, 7th Ed., 2003, p. 51.
5. Todaro and Smith, op. cit., p. 58.
6. Diverse opinions were there about the real meaning of 'development'—by mid 1940s upto almost the whole 1950s it meant 5–7 per cent growth rate in an economy—even by the IMF and WB. By the late 1960s ***new views*** of development started emerging. **Arthur Lewis** had seen development in the sense of *human freedom* in 1963 itself when he concluded that "the advantage of economic growth is not that wealth increases happiness, but that it increases the range of human choice." For him development means a freedom from 'servitude'—mankind could be free to have choices to lead a life full of material goods or in spiritual contemplation (W. Arthur Lewis, ***The Theory of Economic Growth,*** Allen & Unwin, London, 1963, p. 420).

   For **Dudley Seers** development meant more employment and equality besides a falling poverty (***The Meaning of Development,*** a paper presented at the 11th World Conference of the Society for International Development, N. Delhi, 1969, p. 3). Dudley Seers was later supported by many other economists such as **Denis Goulet** (***The Cruel Choice: A New Concept in the Theory of Development,*** Atheneum, New York, 1971, p. 23), Richard Brinkman (1995), P. Jegadish Gandhi (1996) and many others.

   The **International Labour Organisation** (ILO) had also articulated by the mid-1970s that economic development must be able to deliver the economic ability that people can meet their basic needs (the concept of 'sustenance') besides the elimination of

absolute poverty, creating more employment and lessening income inequalities (***Employment, Growth and Basic Needs,*** ILO, Geneva, 1976). **Amartya Sen** articulated a similar view via his ideas of 'capabilities' and 'entitlements' ("Development: which way Now?", ***Economic Journal 93,*** December 1983, pp. 754–757.).

By 1994, the United Nations looked to including the element of 'capabilities' in its idea of development when it concludes that ***human beings are born with certain potential capabilities and the purpose of development is to create an environment in which all people can expand their capabilities in present times and in future. Wealth is important for human life. But to concentrate exclusively on it is wrong for two reasons. First, accumulating wealth is not necessary for the fulfillment of some important human choices .... Second, human choices extend far beyond economic well-being (Human Development Report 1994, UNDP,*** Oxford University Press, New York, 1994, pp. 13–15).

The **World Bank** by 1991 had also changed its view about development and had concluded that improving *quality of life* is time the WB had already included education, health, nutrition, less proverty, cleaner environment, equality, greater freedom and richer cultural life as the goals of development.

Amartya Sen, a leading thinker on the meaning of development attracted attention for articulating human goals of development. He opined that enhancing the lives and the 'freedoms' we enjoy should be the concerns of development known as the 'capabilities' approach to development (see his ***Commodities and Capabilities,*** North Holland, Amsterdam, 1985 and ***Development as Freedom.*** Alfred Knopf. New York, 1999.).

7. **Stefan Priesner**, a senior economist with the UNDP conducted the study for the John Hopkins University, USA, in 2005.

3

EVOLUTION OF THE INDIAN ECONOMY

*After 1757, when the East India Company took over the governance of Bengal, the British relationship with India, became exploitative, as exports to Britain and opium exports to China were financed out of the tax revenue from Bengal. There is not much evidence of significant transfer of European technology to Asia. To understand why, it is useful to scrutinize the experience of China and India, as they accounted for three-quarters of the Asian population and GDP in 1500 AD.**

- The Background
- Prime Moving Force—Agriculture vs. Industry
- Planned and Mixed Economy
- Emphasis on the Public Sector

** See Angus Maddison, 'Growth and Interaction in the World Economy: The Roots of Modernity', The AEI Press, Washington, DC, 2005, p. 60.*

THE BACKGROUND

The economic profile of India was in complete distress at the time of independence. Being a typical case of colonial economy, India was serving a purpose of development not for herself but a foreign land—the United Kingdom. Both agriculture and industry were having structural distortions while the state was playing not even a marginal role. During the half century before India became independent, the world was having accelerated development and expansion in its agriculture and industry on the shoulders of the active role being played by the states, with the same happening in the UK itself.[1]

There was not only the unilateral transfer of investible capital to Britain by the colonial state (the 'drain of wealth') but the unequal exchange was day by day crippling India's commerce, trade and the thriving handloom industries, too. The colonial state practiced policies which were great impediments in the process of development in the country. Throughout the colonial rule, the economic vision the state had was to increase India's capacity to export primary products, and increase the purchase/import of the British manufactured goods and raise revenues to meet the drain of capital as well as meet the revenue requirements of the imperial defence.[2]

The social sector was a neglected area for the British rulers which had a negative impact on the production and productivity of the economy. India remained a continent of illiterate peasants under British rule. At the time of independence, its literacy was only 17 per cent with 32.5 years of life expectancy at birth.[3]

Industrialisation of India was also neglected by the colonisers—the infrastructure was not built to industrialise India but to exploit its raw materials. Indian capitalists who did emerge were highly dependent on British commercial capital and many sectors of industry were dominated by British firms, e.g. shipping, banking, insurance, coal, plantation crops and jute.[4]

The pre-independence period was altogether a period of near stagnation showing almost no change in the structure of production or in the levels of productivity—the aggregate real output during the first half of the 20th century estimated at less than 2 per cent a year or less.[5]

The overall economic performance of India under the British rule was very low. According to economic statistian Angus Maddison, there was no per capita growth in India from 1600 to 1870—per capita growth was a meagre 0.2 per cent from 1870 to 1947, compared with 1 per cent in the UK.[6] The per capita incomes of Rs. 18 for 1899 and Rs. 39.5 for 1895 in current prices say the true story of the abject poverty Indian masses were faced with.[7] The repeated famines and disease epidemics during the second half of the nineteenth century and the first half of the twentieth century show the greatest socio-economic irresponsibility and neglect of the British Government in India at one hand and the wretchedness of the masses at the other.[8]

The political leaders and the industrialists both were very much aware and conscious about the economic inheritance once India became independent. Somehow, these dominant lot of people who were going to lay down the foundation stones of the independent Indian economy were almost having consensual[9] view, even before the independence, on many major strategic issues:

(i) State/Governments should be given a direct responsibility for development.

(ii) An ambitious and vital role to be assigned to the public sector.

(iii) Necessity for the development of the heavy industries.

(iv) Discouragement to foreign investment.

(v) The need for economic planning.

Once India became independent, it was a real challenge for the Government of the time to go for a systematic organisation of the economy. This was a task full of every kind of challenges and hurdles as the economy had hardly anything optimistic. The need of delivering growth and development was in huge demand in front of the political leadership as the country was riding on the promises and vibes of the nationalist fervour. It was not a simple task.

Now the decisions which were to be taken by the political leadership of the time were going to shape the very future of India. Many important and strategic decisions were taken only by 1956 which shaped Indian economic journey till date— undoubtedly they heavily dominated the pre-reform period but the post-reform period is also not completely free of their impact. To understand the nature and scope of the Indian economy in current times it is not only useful but essential to go through the facts, reasons and the delicacies which made the economy evolve and unfold the way it evolved and unfolded. A brief overview follows.

PRIME MOVING FORCE—AGRICULTURE VS. INDUSTRY

A topical issue of debate regarding India has been the choice for the sector which will lead the process of development. The government of the time opted for industry to be India's prime moving force of the economy. Whether India should have gone for agriculture as its prime moving force for better prospects of development, is a highly debatable issue even today among experts.

Every economy has to go for its development through exploitation of its natural and human resources. There are priorities of objectives set by the economy which is attempted to be realised in a proper time frame. The availability and the non-availability of resources (natural as well as human) are not the only issues which make an economy decide to declare whether it opts for agriculture or industry as its prime moving force. There are many more socio-political compulsions and objectives which play their roles in such decision making.

The political leadership selected industry as the leading force of the economy after independence—this was already decided by the dominant group of the nationalist leaders way back in the mid-1930s when they felt the need for economic planning in India before setting up the National Planning Committee (1938). Given the available resource base it seems an illogical decision as India lacked all those pre-requisites which could suggest the declaration of industry as its prime mover:

(i) Almost no presence of infrastructure sector i.e. power, transportation and communication.

(ii) Negligible presence of the infrastructure industries i.e. iron and steel, cement, coal, crude oil, oil refining and electricity.

(iii) Lack of investible capital—be the case of either the government or the private sector.

(iv) Absence of the required technology to support the process of industrialisation and no research and development.

(v) Lack of skilled manpower.

(vi) Absence of entrepreneurship among the people.

(vii) Absence of the market for industrial goods.

(viii) Many other sociopsychological factors which were negative forces for the proper industrialisation of the economy.

The obvious choice for India would have been the agriculture sector as the moving force of the economy because:

(i) The country was having the natural resource of fertile land which was fit for cultivation.

(ii) The human resource was not requiring any kind of higher training.

By only organising our land ownership, irrigation and other inputs to agriculture India could have gone for better prospects of development. Once there was no crises of food, shelter, basic healthcare, etc. to the masses, one goal of development could have been realised—a general welfare of the people. Once the masses were able to achieve a level of purchasing capacity, India could have gone for the expansion of industries. India was capable of generating as much surplus income for its masses as was required by the emerging industries for a market success. The People's Republic of China did the same in 1949—taking a realistic evaluation of its resources, it declared agriculture as its prime moving force for the economy. The surplus generated out of agriculture was suitably invested to develop the pre-requisites for industrialisation and the country went for it in 1970s.

The emergence of industrial China was so vibrant that its impact was felt in the so-called highly developed and industrialised economies of the world—the industrial homework of China catapulted it into a giant.

Was the political leadership of independent India not able to analyse the realities as we did above and conclude that agriculture should have been the moving force of the economy in place of industry? Is it possible that Pandit Nehru in command could have missed the rational analysis of the Indian realities, a giant among the Asian visionaries of the time (Mao was still to emerge on the international scene)? How India could have not opted for agriculture as its prime moving force whose leadership had fought the nationalist movement on the Gandhian fervour of villages, agriculture and rural development. Even if Gandhi was not in the Government there were many devout Gandhians in it and no one should doubt that the main internal force which vibrated throughout the governmental decisions were nothing but 'Gandhian Socialism'. There were many decisions which were taken under the influence of the main political force of the times, still some very vital ones were influenced by the visionary hunches of the political leadership mainly being J.L. Nehru. This is why the economic thinking of independent India is considered and said to be nurtured by the Nehruvian Economics still today. If we go through the major literatures on the Indian economic history, views of the critiques of the time and the contemporary experts, we may be able to feel the answer as to why India went for industry as its prime moving force in place of an obvious and logical choice of agriculture (we should not be happy to know that even today this is a highly debatable issue among experts):

(i) Looking at the resources available, agriculture would have been the obvious choice as the prime moving force (PMF) of the economy (i.e. cultivable land and the manpower). But as Indian agriculture was using the traditional tools and technology its modernisation as well as future mechanisation (latter to some extent) would have been blocked due to the lack of

indigenous industrial support. If we had gone for import this would have required enough foreign reserves and a natural dependence on foreign countries. By choosing industry as the PMF we were going to industrialise the economy as well as modernise our traditional mode of farming.

(ii) The dominant ideology around the world as well as in the WB and the IMF was in favour of industrialisation as a means to faster growth which could be translated into faster development. These international bodies were supporting the member countries from every point of view to industrialise. Same was the case with the developed economies. It was possible not only to industrialise faster on these supports but a hope for emerging as an industrial exporter was also there. Such kind of supports were not being offered by them to an economy going to opt for agriculture as its PMF. Basically, going for the sector agriculture was considered a symbol of 'backwardness' at that time also. The political leadership wanted to carry India ahead, and not in the backward direction. It was only in the 1990s that the world and the WB/IMF changed its opinion regarding agriculture sector—and emphasis on this sector by an economy was no more considered a sign of backwardness.

(iii) The Second World War has proved the supremacy of defence power. For defence a country needs not only support of science and technology but an industrial base also. India also required a powerful defence base for herself as a deterrent force. By opting for industry as her PMF the economy tried to solve many challenges simultaneously—first, industry will give faster growth, second, agriculture will be modernised in time and third the economy will be able to develop its own defence force. Since the economy had opted for scientific and technological preparedness also, its achievements were to sustain the pace of modernising world out there (this seems taking place in India to a great extent.).

(iv) Even before independence, there was a socio-economic consensus among social scientists along with the nationalist leaders, that India needed a boost towards social change as the country lagged behind in the areas of modernisation. A break from the traditional and outmoded way of life and cultivation of a scientific outlook was a must for the country. Such feelings also made the political leadership of the time go in favour of wholehearted industrialisation.

(v) By the time India got her independence the might of industrialisation was already proven and there were no doubts regarding its efficacy.

Given above are some of the important reasons that worked to make Indian political leadership go in favour of opting industry as the economy's prime moving force. Probably, the resource-related and temperamental realities of India got marginalised in hopes and wishes of a future industrialised and developed India. It is yet impossible to conclude whether the economy has completely failed to do so. Experts have divided opinions on this issue.

The last decade of the 20th century (i.e. the decade of 1990s) saw major changes taking place in the world economic idea about the agriculture sector. It was no more a symbol of backwardness for an economy if it had started emphasising its agriculture sector as the engine of growth and development. China had proved to the world that how agriculture could be made the prime moving force of economy and generate internal as well as external strength to emerge as an industrial economy. In the wake of ongoing reform process India was introspecting almost all economic policies it followed

since independence. It was time for agriculture sector to have the prime attention. A major shift[10] took place in the Indian economic thinking when the Government announced in 2002 that now onwards, in place of industry, **agriculture will be the prime moving force (PMF)** of the economy. This was a policy shift of historic importance which was announced by the highest economic think tank of the country—the Planning Commission—as the economy commenced the Tenth Plan (2002–07). As per the Planning Commission[11] such a policy shift will solve the three major challenges faced by the economy:

1. Economy will be able to achieve food security with the increase in the agricultural production. Besides, the agricultural surplus will generate exports in the globalising world economy benefiting out of the WTO regime.
2. The challenge of poverty alleviation will be solved to a great extent as the emphasis will make agriculture a higher income-generating occupation and induce growth in the rural economy by generating more gainful employment.
3. The situation of India as an example of 'market failure' will cease.[12]

Though the world outlook towards agriculture sector had changed by the early 1990s, the Government of India announced the policy shift more than one decade later. There is now a consensus among the experts, policy-makers and the governments alike that for development to take place in India it is necessary to strengthen the sector on which the masses depend for their income and livelihood. More than 65 per cent of the Indian population depends on agriculture and allied activities while only 18.5 per cent of the gross domestic product (GDP) comes from the sector.[13] It means that above 65 per cent of Indian population shares just 18.5 per cent of the gross income generated by the economy. The rest of the population that does not depend on agriculture (i.e. below 35 per cent) share 81.5 per cent gross income generated by the economy. The gap of income shows the lower purchasing power of the people involved in agricultural activities—which is more than two-third of the total population. How market can succeed in such a situation and what to ask of the market economy. As the economy was more in favour of market economy, the situation of market failure needed to be arrested The income of the population dependent on the agriculture sector needed strengthening. Though the effects of the policy shift are not clearly visible yet, we may glance at the major policies which are intended towards the strengthening of the agriculture sector:

(i) **New Agriculture Policy, 2000:** The policy mainly intends to convert agriculture into the category of industry so that the population dependent on it could earn income and profit out of agricultural activities with the same pace and mode as the industry has enabled the population dependent on the industrial activities.

(ii) **National Agricultural Insurance Scheme, 1999–00:** The new insurance scheme launched for agriculture intends to provide insurance coverage to all agricultural activities right from seeds, sowing, harvesting to marketing risks—a necessary support to which the industry had access but agriculture had no reach.

(iii) **Exim Policy, 2002–07:** The Export Import Policy, 2002–07 for the first time accepted at the policy level the long-standing opinion of the experts—that a one per cent increase of the agricultural products in India's exports supplies additional Rs. 8,500 crores to the agricultural sector. Many policy initiatives were taken to increase the share of agriculture in the total export of the economy.

(iv) **Second Green Revolution:** A major programme to boost the agricultural production with the sustainable approach was launched in 2004 with an initial corpus of Rs. 50,000 crore.

(v) **Bharat Nirman:** A major programme to focus on the agricultural and rural infrastructure (totalling six items) was launched by the Government in 2005 with the ultimate intention of strengthening rural economy.

(vi) **Others:** Similarly, many time-bound programmes and schemes have been launched since 2002 which focus on the agriculture sector and the rural areas from different angles—education, electricity, wage, as well as self-employment, healthcare, communication, etc.

Looking at the size of population depending upon the agriculture sector, comparatively longer government apathy to the agricultural realities and the late start of reform process in it make things very tough to effect visible changes in the sector in a short time. It also requires comparatively longer period of time. We will then be able to see the visible results of the policy shift as well as the results of the economic reforms in the agriculture sector provided there remains a continued political commitment to the cause. One positive development of the last decade has been that India has been able to reach a silent political consensus on some of the very important aspects of development (for example—on the process of economic reforms, foreign investment, deregulation, social justice, emphasis on agricuture, priority to the social sector, etc.) which gives us hope that the economy will be able to take care of the agriculture sector in due course and more accelerated growth and development can be achieved.

PLANNED AND MIXED ECONOMY

Independent India was declared to be a planned and a mixed economy. India needed national planning, it was decided by the political leadership almost a decade before independence.[14] India was not only facing regional disparities at the level of resources but inter-regional disparities were also prevalent, since centuries. Mass poverty could only be remedied once the government started the process of economic planning. Economic planning was thus considered an established tool of doing away with such disparities.

Basically, it was the abject poverty of the masses which made the government go for planning so that it could play an active role in the allocation of resources and mobilise them for an equitable growth and development. Though India was constitutionally declared a federation of states, in the process of planning, the authority of regulation, directing and undertaking economic activities got more and more centralised in the Union government.[15]

India’s decision for a planned economy was also moulded by some contemporary experiences in the world.[16] *Firstly,* the Great Depression of 1929 and the reconstruction challenges after the Second World War had made experts to conclude in favour of a state intervention in the economy (opposite to the contemporary idea of ‘non-interference’ as proposed by Adam Smith). *Secondly,* it was the same time that the command economies (i.e. state economies) of the Soviet Union and the East European countries started making news about their faster economic growth. In the 1950s and 1960s, the dominant view among the policy makers around the world was in favour of an active role of the state in the economy. *Thirdly,* a dominant role for the state in the economy to neutralise market failures

situation (as happened during the period of the Great Depression when demand fell down to the lowest levels) was gaining ground around the world. For many newly independent developing nations, economic planning was therefore an obvious choice. Economic planning was considered to help states to mobilise resources to realise the prioritised objectives in a well-defined time frame.

Once the political leadership had decided in favour of a planned economy for India and a major role for the state in the economy, they needed to clarify about the organisational nature of the economy—whether it was to be a state economy or a mixed economy—because planning was not possible in a free market economy (i.e. capitalistic economy). The idea of planning in India was inspired from the Soviet planning which was a command economy and did not suit the requirements of democratic India which was till now a privately owned economy.[17] The dominant force behind planning in India, at least after independence, was Nehru himself who had strong socialist leanings. He thought it very urgent to define the role of state in the economy which was going to be at times similar to the State in the Soviet Union and at times completely dissimilar to it. Though there was an example of a capitalistic-democratic system going for planning in France by that time (1947), it had little experience to offer the Indian policy-makers (France had gone for mixed economy by 1944–45). With the basic urge to accelerate the process of economic growth, the planners went to define the respective roles of the state and the market, in the very first Plan itself. The following lines look refreshingly ahead of the times and crystal-clear about the scope of the government's role in the economy vis-a-vis the private sector.

"This brings us to the problem of the techniques of planning. A possible approach to the problem is, as mentioned earlier, through a more or less complete nationalisation of the means of production and extensive system of government controls on the allocation of resources and on the distribution of the national product. Judged purely as a technique of planning, this may appear a promising line of action. But, viewed against the background of the objectives outlined above, and in the light of practical considerations, such an expansion of the public sector is, at the present stage, neither necessary nor desirable. Planning in a democratic set-up implies the minimum use of compulsion or coercion for bringing about a realignment of productive forces. The resources available to the public sector have, at this stage, to be utilised for investment along new lines rather than in acquisition of existing productive capacity. Public ownership of the means of production may be necessary in certain cases; public regulation and control in certain others. The private sector has, however, to continue to play an important part in production as well as in distribution. Planning under recent conditions thus means, in practice, an economy guided and directed by the state and operated partly through direct state action and partly through private initiative and effort."[18] The above-quoted lines are imaginatively ahead of the times. It will be suitable to note here that as 1950s and 1960s made the world experts favour state intervention in the economy, the ***East Asian Miracle (WB)***[20] of the coming three decades was going to define the very limits of such an intervention. The East Asian economies were able to sustain a high growth rate over three decades and had revived again the discussions regarding the respective roles of the state and the market as well as the nature of the state's role in the economy. The kind of conclusions drawn were very similar to the view presented in India's First Plan itself which was presented by the World Bank in 1993[19].

The real nature of the Indian brand of mixed economy, though beautifully outlined in 1951 itself, went

through a process of detailed evolution in the decade of 1950s[20]. By the end of the 1950s, the concept of the mixed economy was almost buried and rose from hibernation only by mid-1980s and finally early in 1990s, in the wake of the process of economic reforms.

The state–market (i.e the public sector and private sector) mix defined for India though, clearly delineated the nature of mixed economy, the vision was obviously blurred in the coming decades as part of economic mismanagement. The imagined mixed economy of India will become more clear in the next sub-topic following ahead.

EMPHASIS ON THE PUBLIC SECTOR

The state was to be given an active and dominant role in the economy, it was very much decided by the time India became independent. There were no doubts about it in the minds of the people who formed the dominant political force at the time. Naturally, there was going to be a giant structure of the government-controlled enterprises to be known as the public sector undertakings (PSUs). Criticism aside, there were at that time , a strong logic behind the glorification of the PSUs. Some of the reasons for heavy investments in the PSUs were purely natural while others were consequential in nature. There were certain highly commendable objectives set for them, some other goals would go on to serve the very soul of the mixed economy. We must go for an impartial and rational analysis of the matter, in the midst of all the criticism of the PSUs and the contemporary moves of privatising them, to understand their roles in the Indian economy. We may understand the reasons behind the ambitious expansion of the PSUs in the face of the following major requirements.

1. Infrastructural Needs

Every Economy whether it is agrarian, industrial or post-industrial, needs suitable levels of infrastructure such as—power, transportation and communication. Without their healthy presence and expansion, no economy can grow, and develop.

At the eve of independence, India was having almost no presence of these three basic requirements. There was just a beginning in the area of railways and post and telegraph. Power was restricted to selective homes of government and the princely states. [It means, even if India had opted for agriculture as its prime moving force (PMF), it had to develop the infrastructure sector.]

These sectors require too much capital investment as well as heavy enginering and technological support for their development. Expansion of the infrastructure sector was considered not possible by the private sector of the time as they could possibly not manage the following components:

(i) heavy investment (in domestic as well as foreign currencies),
(ii) technology,
(iii) skilled manpower, and
(iv) entrepreneurship.

Even if these inputs were available to the private sector it was not feasible for them as there was no market for such infrastructure. These infrastructures were essential for the economy but they needed either subsidised or almost free supply as the masses lacked the market-determined purchasing

capacity. Under these typical condition, it was only the government which could have shouldered the responsibility. The government could have managed not only the inputs required for the development of the sector but could also supply and distribute them to the needy areas and the consumers for the proper growth of the economy. There were no alternatives and that is why infrastructure sector in India has such a dominant state presence that many areas have obvious government monopolies—as in power, railways, aviation, telecommnication, etc.

2. Industrial Needs

India had opted for the industry sector as its prime moving force, as we saw in the earlier pages. Now there were some areas of industries which the government had to invest in, due to several compulsive reasons. For industrialisation and its success, every economy needs the healthy presence of some 'basic industries' which are also known as the 'infrastructure industries'.[21] There are six basic industries which every industrialising economy requires, namely—

(i) Iron and Steel
(ii) Cement
(iii) Coal
(iv) Crude oil
(v) Oil refining and
(vi) Electricity.

[***Note:*** At present, there are eight ***Core Industries*** in India (with the Base: 2004-05=100), six existing *'basic/infrastructure industries'* with two new additions i.e. *Natural Gas* and *Fertilizer*. Core Industries together have a combined weight of 37.90 per cent in the Index of Industrial Production (IIP). Individual percentages of them are – Coal (weight: 4.38%); Crude Oil (weight: 5.22%); Natural Gas (weight: 1.71%); Petroleum refinery (weight: 5.94%); Fertiliser (weight: 1.25%); Steel (weight: 6.68%); Cement (weight: 2.41%); and Electricity (weight: 10.32%).]

Similar to the infrastructure sector, these basic industries also require high level of capital, technology, skilled manpower and articulation in entrepreneurship which was again considered not feasible for the private sector of the time to manage. Even if the private sector supplied goods from the 'basic industries' they might not be able to sell their products in the market due to the lower purchasing power of the consumers. Perhaps, that is why again the responsibility of developing the basic industries was taken up by the government.

Out of the six basic industries the cement sector was having some strength in the private and in iron and steel sector a lone private company was present. The coal sector was controlled by the private sector and crude oil and refining was just a beginning by them. The level of demands of an industrialising India was never to be met by the existing strength of the basic industries. Neither the required level of expansion in them was possible by the existing number of private players. With no choice left, the government decided to play the main role in them. In many of them we as a result, see a natural monopoly for the PSUs, again.

3. Employment Generation

The PSUs were also seen as an important part of the employment generation strategy. A government in, democratic set up, cannot think only economics but it has to realise the sociopolitical dimensions of the nation too. The country was faced with the serious problem of poverty and the workforce was increasing at a fast rate. Giving employment to the poor people is time-tested tool of poverty alleviation. The PSUs were thought to create enough jobs for the employable workforce of the economy.

There was also felt an immediacy for a social change in the country. The poverty of a greater section of the country was somehow connected to the age-old caste system which propitiated the stronghold of the upper castes on the ownership of land which was the only means of income and livelihood for almost above 80 per cent of the population. Along with the ambitious policy of the land reforms the Government had decided to provide reservations to the weaker sections of the society in the government jobs. The upcoming PSUs were supposed to put such jobs at the government disposal which could have been distributed along the decided reservation policy—such reservations were considered an economic tool for social change.

In the highly capital-intensive sectors in which the government companies were going to enter, managing investible funds to set them up was not going to be an easy task. The government did manage the funds with sources like taxation, internal and external borrowing and even taking last refuge in the printing of fresh currencies. The government went to justify the high taxation and heavy public indebtness in supplying employment to the Indian employable population.

The PSUs were considered by the government as the focus of the ‘trickle-down effect’. The government did everything to set up and run the PSUs as the benefits were supposed to percolate to the masses, finally reinforcing growth and development in the country. Employment in the PSUs was seen as the effort of the trickle down theory, simply said. At a point of time, Nehru even mentioned the PSUs as the ‘temples of modern India’. The government went to commit even a job in every household via the PSUs—without calculating the dimensions of the future labourforce in the country and the required resources to create the jobs at such a high scale. But the government went on creating new PSUs without analysing the fiscal repercussions—moreover believing them to be the real engine of equitable growth. Employment generation responsibility of the PSUs was extended to such an extent by the government that most of them had over-supply of the labour force which started draining its profits on account of the salaries, wages, pensions and the provident funds (latter two had late financial impact).

4. Profit and Development of the Social Sector

The investment to be made by the government in the PSUs was in the nature of asset creation and these entities were to be involved in production activities. It was natural for the government to gain control over the profits and dividends accruing from them. The goods and services the PSUs were to produce and sell were going to provide disposable income to the government. The government had a conscious policy of spending the income generated by the PSUs. They were to be used in the supply of the ‘social goods’ or what is called the ‘public goods’. And thus, India was to have a developed social sector. By social goods the government meant the universal supply of certain goods and services to the Indian people. They included education, healthcare, nutrition, drinking water, social security, etc. in India. It means that the PSUs were also visioned as the revenue generators for the

development of the social sector. Due to many reasons the PSUs would not be able to generate as much profit as was required for the healthy development of the social sector. This eventually hampered the availability of public goods in the country. In place of giving profits back to the government, a very high number of the PSUs started incurring huge losses and required budgetary supports as a regular phenomenon.

5. Rise of the Private Sector

As the PSUs will take the responsibility of supplying the infrastructure and the basic industries to the economy, a base for the rise of private sector industries will be built. With the rise of the private sector industries in the country, the process of industrialisation will be completed. Out of the many roles the PSUs were supposed to play this was the most far-sighted. Whatever happened to the different roles the PSUs were assigned is a totally different matter to which we will return while discussing the industrial scenario in the country. Here we have analysed why the government in India after Independence went for such an ambitious plan of expansion of the public sector.

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7. The respective data of Digby and Atkinson have been quoted by Sumit Sarkar, **Modern India 1885–1947,** Macmillan, N. Delhi, 1983, p. 42.
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9. Bipan Chandra et. al., **India's Struggle for Independence,** Penguin Books, N. Delhi, 1989, p. 15.
10. The Government of India had shown such an intention in two regular Union Budgets (i.e. the fiscals 2000–01 and 2001–02) but has not announced the shift officially.
11. **Tenth Five Year Plan (2002–07),** Planning Commission, GoI, N. Delhi, 2002.
12. It has been argued by the economists time and again that India is a typical example of 'market failure'. Market failure is a situation when there are goods and services in an economy and its requirement too but due to lack of purchasing power the requirements of the people are not translated into the demand. Whatever industrial goods and services India had been able to produce they had stagnated or stunted sales in the market as the largest section of the consumers earned their livelihood from the agriculture sector unable to create a purchasing power to the levels required by the market. As agricultural activities will become more gainful and profitable the masses depending on it will have the level of purchasing capacity to purchase the industrial goods and services from the market. Thus, the Indian market won't fail. The view has been articulated by *Amartya Sen* and *Jean Dreze* in their monograph titled ***India: Economic Development and Social Opportunity,*** United Nations University 1996.
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21. ‘Infrastructure sector’ and ‘infrastructure industries’ are quite different things.

4

ECONOMIC PLANNING

*The idea of planning and a planned society is accepted now in varying degrees by almost everyone. But planning by itself has little meaning and need not necessarily lead to good results. Everything depends on the objectives of the plan and on the controlling authority, as well as, of course, the government behind it.**

- Introduction
- Definition
- Origin and Expansion
- Types of Planning

** As Jawaharlal Nehru writes in 'The Discovery of India', Oxford University Press, 6th Impression (1st Edition 1946, Oxford, London), N Delhi, 1994, p. 501.*

INTRODUCTION

In order not to limit the discussion on economic planning to just an academic exercise, we need to discuss it taking real life examples from different economies. Without a historical background to planning, we would not be able to understand the meaning and role of planning in India. This small chapter intends to brief the reader on all the ***whats, hows*** and ***whys*** of the concept of economic planning with due recourse to the experiments by different countries from time to time, including India. It could also be considered a theoretical backup for the next chapter, *Planning in India.*

DEFINITION

A number of definitions have been forwarded by different economists from time to time since the term 'planning' entered the domain of economics. To make us develop a clear understanding of planning, we need to see only a few of them which will enable us to draw out a working definition that fits contemporary time.

A large number of economists and experts have agreed that perhaps the best definition is given by H. D. Dickinson, according to whom, economic planning is, "the making of major economic decisions—what and how much is to be produced and to whom it is to be allocated by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole."

It was the National Planning Committee, set up in 1938 by the Indian National Congress which, for the first time, tried to define planning (in 1940, though, its final report was published in 1949) in India. It could be considered the broadest possible definition of planning: "Planning, under a democratic system, may be defined as the technical coordination, by disinterested experts of consumption, production, investment, trade, and income distribution, in accordance with social objectives set by bodies representative of the nation. Such planning is not only to be considered from the point of view of economics, and raising of the standard of living, but must include cultural and spiritual values, and the human side of life."[1]

By the late 1930s, there was an almost political consensus that independent India will be a planned economy. As India commenced economic planning by the early 1950s, the Planning Commission of India also went on to define planning. According to the Planning Commission, "Planning involves the acceptance of a clearly defined system of objectives in terms of which to frame overall policies. It also involves the formation of a strategy for promoting the realisation of ends defined. Planning is essentially an attempt at working out a rational solution of problems, an attempt to coordinate means and ends; it is thus different from the traditional hit-and-miss methods by which reforms and reconstruction are often undertaken"[2] .

In the post-War period, a large number of the newly independent countries were attracted towards planning. Many new forces of change kept refining the very idea of planning due to the compulsive necessities of industrialisation or the issue of sustainability of the development process. But to carry forward our discussion, we need a working as well as a contemporary definition of planning. We may define it as *a process of realising well-defined goals by optimum utilisation of the available*

resources.[3] While doing economic planning the government sets developmental objectives and attempts to deliberately coordinate the economic decision making over a longer period to influence, direct and in some cases even to control the level and growth of a nation's main economic variables (i.e. income, consumption, employment, saving, investment, exports, imports, etc.).[4]

An economic plan is simply a set of specific economic targets to be achieved in a given period of time with a stated strategy. Economic plans may be either comprehensive or partial. A ***comprehensive plan*** sets targets to cover all major aspects of the economy while a ***partial plan*** may go for setting such targets for a part of the economy (i.e. agriculture, industry, public sector, etc.). Taken broadly, the planning process itself can be described as an exercise in which a government first chooses social objectives, then sets various targets (i.e. economic targets), and finally organises a framework for implementing, coordinating, and monitoring a development plan.[5]

One very important thing which should be clear to all is that the idea of planning first emerged in its applied form and after studying and surveying the experiences of different countries who followed it, experts started theorising about planning. Thus, in the case of planning, the direction has been from practice to theory. This is why the form and the nature of planning kept changing from country to country and from time to time. As we will see in the following pages, the types of planning itself evolved through time as different countries experimented with it.

As per our working definition, we may say the following things about planning:

(i) ***Planning is a process.*** It means planning is a process of doing something. Till we have some goals and objectives left regarding our lives, the process might continue. With the changing nature of our needs, the nature and scope of the planning process might undergo several changes. Planning is not an end in itself. As processes accelerate and decelerate, change direction and course, so also does planning.

(ii) ***Planning must have well-defined goals.*** After the Second World War, several countries went for development planning. As these nations had enormous socio-economic hurdles, they first set some goals and objectives and then started their process of realising them via planning. In due course of time, there emerged a consensus that planning must have some goals and those goals should be well-defined (not vaguely defined)—so that the government's discretionary intervention in the economic organisation could be democratically transparent and justified. Even in the non-democratic nations (i.e. erstwhile USSR, Poland, China, etc.) the goals of planning were clearly defined.[6]

(iii) ***Optimum utilisation of the available resources.*** Here we see two catch concepts. *First,* is the way of utilising the resources. Till the idea of sustainability emerged (1987) experts tried to 'maximise' the resource exploitation. But once the experts around the world introspected the untenability of such a method of resource utilisation, the sustainable approach was included into planning and here in entered the idea of utilising resources at its 'possible best' level so that environmental degradation could be at its minimum and the future generations could also be able to continue with their progress. *Second,* it is the idea of the nature resources which are available. Resources (i.e. natural as well as human) could be of indigenous origin or exogenous. Most of the countries doing planning tried to utilise their indigenous resources, yet some others tried to tap the exogenous resources too, taking leverage to their diplomatic acumen. For example, the first country going for national planning

i.e. Soviet Union leveraged resources available in the East European countries. India also used exogenous resources for her development planning wherever it was necessary and possible to tap.[7]

By 1950s, planning had emerged as a method or tool of utilising resources to achieve any kind of goals for the policy-makers, around the world:

(i) Trying to achieve a particular size of family for different countries came to be known as ***family planning.***

(ii) The process of providing suitable physical and social infrastructure for the erstwhile or the upcoming urban areas came to be known as ***town/urban planning.***

(iii) A country trying to optimise the use of its revenues for different categories of expenditures came to be known as ***financial planning.*** Financial planning is more popularly known as ***budgeting.*** Every budget, be it of the government or of the private sector is nothing but excercises in the area of financial planning.

(iv) Similarly, at macro and micro levels, there might be any number of planning processes—agricultural planning, industrial planning, irrigation planning, road planning, house planning, etc.

Simply said, the art of achieving any kind of goal by the use of the resources we have is the process of planning. We may cite a very general example—students of a class are able to join the class at the right time coming from different places of their stay. How they are able to do so? All of them must be planning their time in such a way that they are able to join the class at the same time though their places of residence are not at an equal distance from the class. All might be having their own way of time planning—some might be having bed-tea, some might not, some might be having breakfast at their place, yet some others might think to take their breakfast in the college canteen, etc.

It means that even if we are not consciously planning or have not announced it as yet, we are always planning our days. Same is correct in the case of countries also. Many countries announced that they will be planned economies yet some others didn't go for any such policy announcements. The Soviet Union, Poland, China, France, India are examples of the former category while the USA, Canada, Mexico fall in the latter category.[8] But here we are concerned with the conscious process of planning. There will be some methods, some tools and types of planning emerging through time as different countries will start their processes of planning.

ORIGIN AND EXPANSION OF PLANNING

Planning as a method of achieving faster economic progress has been tried by different countries at different times and at different levels. We may see them as under:

1. Regional Planning

It was at the regional level that planning was used as a part of development policy by any country for the *first time.* It was the USA which started the first regional planning after the Tennessee Valley

Authority (TVA) was set up in 1916—for a large-scale rehabilitation in south-eastern USA covering parts of seven states. With the primary aim of flood control, soil conservation and providing electricity, the TVA/the regional plan was also involved in many related activities such as industrial development, forestry, wildlife conservation, town planning, construction of road and rail, encouraging sound agricultural practices and malaria control in the defined region.[9] The US experience of regional planning became such a success in realising its well-defined goals that it emerged as a role model and an object of inspiration for many countries around the world in the coming decades—the Damodar Valley Corporation (DVC) in India (1948), the Volta River Project in Ghana (1966), etc.

2. National Planning

The official experiment in the area of national planning is rooted in the Bolshevik Revolution of Russia (1917)—the Soviet Union. Dissatisfied with the pace of industrialisation, it was in 1928 that Joseph Stalin announced its policy of central planning for the Soviet Union. The collectivisation of agriculture and forced-draft industrialisation were other radical new policy initiatives announced by Stalin besides economic planning in 1928.[10] The Soviet Union went for its first five year plan for the period 1928-33 and the world was to have its *first* experience of *national planning*. The famous Soviet slogan "great leap forward" was initiated for rapid industrialisation through the introduction of economic planning at the national level. The nature and scope of Soviet planning (called ***the Gosplan***) will have its direct or indirect bearings on all those countries who went for economic planning, be they state economies or capitalist or mixed economies. India was to have direct bearings of Soviet planning on its planning process. In the first Soviet Plan, heavy industry was to be favoured over light industry, and consumer goods were to be the residual sector after all the other priorities had been met. We see the same emphasis in the Indian planning process.[11] The Soviet model of economic planning spread to the East European countries, especially after World War II and found its purest form of such planning in the People's Republic of China (1949). During the early 1940s, the concept of national planning was borrowed by France and the world saw national planning being initiated by a hitherto capitalist economy as well as by a non-centralised political system (i.e. democratic system). France started economic planning at the national level after announcing itself a mixed economy.

TYPES OF PLANNING

After the first national planning was started by the Soviet Union, many more countries followed it but with variations in their methods and practices. Though there are many variants of planning the most important one is on the basis of the type of economic organisation (i.e. state economy, mixed economy). During the course of evolution, planning has been classified into two types, based upon the type of economic system the economy has:

1. Imperative Planning

The planning process followed by the state economies (i.e the socialist or communist) is known as the imperative planning. Such planning is also called as ***directive* or *target planning.*** Such planning had two main variants. In the Socialist system, all economic decisions were centralised in the hands of the state with collective ownership of resources (except labour). In the Communist system (i.e. China of past) all resources were to be owned and utilised by the state (including labour, too). Thus, communist China was the purest example of such planning. In the case of Soviet Union a little bit of 'market' did exist—even after the collectivisation of agriculture was enacted by Stalin in 1928 only 94 per cent of Soviet peasants could be included in the process.[12] Basic features of such planning are as under:

(i) *Numerical (i.e. quantitative) targets* of growth and development are set by the plans. As for example, five lakh tonnes of steel, two lakh tonnes of cement, 10,000 kms. of national highways, 5000 primary schools, etc. will be produced/built in the coming 5 or 6 years.

(ii) As the *state* controls the ownership rights over the resources, it is very much possible to realise the above-cited planned targets.

(iii) Almost *no role for market,* no price mechanism with all economic decisions to be taken in the centralised way by the state/Government.

(iv) No private participation in the economy, only state played the economic role.

The ***Command Economies*** followed this kind of planning. That is why such economies are also known as the ***Centrally Planned Economies*** — the USSR, Poland, Hungary, Austria, Romania, etc. and finally China. Basically, it was the migration of some of the great economists from the Soviet Bloc countries to Britain and the USA that a proper study and discussion started on the very nature and purpose of planning in the command economies. Many of these economists went back to their countries of origin after the Second World War to serve and in some measure, suffer the revolution there.[13] It was their articulate and contemporary economic thinking which formed the basis for the idea of mixed economy in the post-War world. One among them was Oskar Lange, the famous Polish economist who after returning home to serve as the Chairman of the Polish State Economic Council (as India has the Planning Commission) suggested and coined the concept of *'market socialism'* in the 1950s. His ideas of market socialism were cancelled by not only Poland but also by the other state economies of the time.[14]

The peak of this type of planning was reached in China after the Cultural Revolution (1966–69) which led to an economic slowdown in the country which had adopted a Soviet-style central planning system after 1949. Under Deng Xiaoping (1977–97), China decentralised a great deal of economic power with its announcement of the "open door policy" in 1985 to save the economy. The Chinese ***open door policy*** was an initiative in the direction of the 'market socialism' under the communist political design itself (a popular student demand for political reform in favour of democracy was ruthlessly repressed in Tiananmen square in 1989). Similarly, the Soviet Union under the leadership of Mikhail Gorbachev began a process of political and economic reforms, called ***prestroika*** (i.e. restructuring) and ***glasnost*** (i.e openness) in 1985 to save the failed economic experiments in the state economy. Other East European economies followed, similar economic reforms 1989 onwards. Thus, the whole world of the state economies had moved towards market economy by the late 1980s. Since then none of the countries have followed imperative planning.

2. Indicative Planning

In the following two decades after the Soviet planning commenced, the idea of planning got attention from the democratic world. A time came when some such economies started national planning. As they were neither the state economies nor Communist/Socialist political systems, the nature of their planning was to be different from the command economies. Such planning has been called as indicative planning by the economists and the experts. Identifying features of indicative planning may be summed up as under:

(i) Every economy following the indicative planning were the mixed economies.

(ii) Unlike a centrally planned economy (countries following imperative planning) indicative planning works through the market (price system) rather than replaces it.[15]

(iii) Side by side setting numerical/quantitative targets (similar to the practice in the imperative planning) a set of economic policies of indicative nature is also announced by the economies to realise the plan targets.

(iv) The indicative nature of economic policies which are announced in such planning basically encourage or discourage the private sector in its process of economic decision making.

After converting to mixed economy by the mid-1940s, France commenced its first six year plan in 1947 which got popularity as the ***Monnet Plan*** (he was the first chairman of the General Planning Commission and the then Cabinet Minister for Planning in France).[16] Later, Monnet Plan became synonymous with indicative planning. This plan is also sometimes described as the *basic sector planning* as the Government had selected eight basic industries as the core of development in which the nature of planning was almost *imperative* i.e. under the state monopoly (these sectors were owned by the private sector till 1944 when France went for their nationalisation)[17]. Other economic activities were open for private participation for which indicative kind of policy-planning was essential. France as well as Japan have followed indicative planning with great successes. It was in 1965 that the UK commenced such a planning with the National Plan and abandoned in 1966 after being overtaken by events (a balance of payment crisis resulting in a deflationary package of measures). Since then the UK never went for the Planning.[18]

Though the first use of economic planning as an instrument of economic progress was done by the USA (with the Tennessee Valley Authority in 1916 at regional level), it never went for a *formal* national planning. In the 1940s, some economists had suggested in favour of the use of national planning. We may have a reflex of indicative planning in the USA if we look at the *Presidentail Reports* which come after regular intervals. These reports are just ‘benchmarks’ in the area of resource utilisation and governmental announcements of its objectives—basically trying to motivate the private sector towards the area of public objectives. The indicative planning as it is practised by the mixed economy, any growth target could only be achieved once the public and the private enterprises worked in tandem. This is why besides the plan targets, the governments need to announce some set of the indicative policies to encourage and motivate the private sector to accelerate their economic activities in the direction of the plan targets.

After the Second World War, almost all the newly independent countries adopted the route of planned development. Though they followed an overall model of the indicative planning, many of them had serious inclination towards imperative planning. As in the case of India, the heavy bias towards

imperative planning could only be reformed once the process of economic reforms was started in 1991.

Today, as there are mostly only mixed economies around the world, any country's development planning has to be only of the indicative type. After the revival of the role and the need of market in promoting growth and development via the Washington Consensus (1985), the Santiago/New Consensus (1998) and the World Trade Organisation (1995), only indicative planning has remained possible with the state playing only a marginal role in the economy especially in the areas of social importance (i.e. nutrition, healthcare, drinking water, education, social security, etc.).

There are still many other types of planning depending upon the point of view we are looking with. For example, from the territorial point of view, planning could be ***regional*** or ***national.*** From the political point of view planning could be ***central, state*** or ***local.*** Similarly, from the participatory point of view, planning has been categorised into ***centralised*** and ***decentralised.*** Again, from the temporal point of view planning could be ***long-term*** or ***short-term*** (in relative sense). Finally, from the value point of view planning could be ***economic*** or ***developmental.***

A major classification of planning is done on the basis of societal emphasis by the planning. The type of planning which gives less emphasis upon the social and institutional dimensions is known as the ***normative planning.*** In such planning, the planners just search for the best possible results in relation to the established goals giving less importance to issues like caste, creed, religion, region, language, marriage, family, etc. Opposed to it, the ***systems planning*** gives due importance to the socio-institutional factors. This is a planning from social-technical point of view but only suitable for a country which has lesser degree of social diversities (naturally, not fit for the Indian conditions). But in the coming years there was a shift in the very thinking of the policy-makers. The *Economic Survey 2010-12* is probably the first GoI document which advocates the need for the ***systems approach*** to planning in India. It is believed that until a programme/scheme run by the governments are not able to connect with the customs, traditions and ethos of the population, their acceptability will not be of the desired levels among the target population. Establishing an empathic relationship between the programmes/schemes and target population is now considered as an important aspect of planning and policy-making. Such a change in the thinking is based on the experiences of India and other countries of the world.

Economic planning is classified into more types—***sectoral*** and ***spatial.*** In sectoral planning, the planners emphasise the specific sector of the economy i.e. agriculture, industry or the services. In spatial planning development is seen in the spatial framework. The spatial dimensions of development might be defined by the pressure and requirements of national economic development. Indian planning has been essentially normative—single level economic planning with a greater reliance on the sectoral approach though the multi-level regional or spatial dimensions are being increasingly emphasised since the early 1990s.

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1. S.R. Maheshwari, ***A Dictionary of Public Administration,*** Orient Longman, N. Delhi, 2002, p. 371.
2. ***First Five Year Plan (1951-56),*** Planning Commission, Government of India, N. Delhi, 1991, p. 7.
3. After the emergence of the concept of ***Sustainable Development*** (1987) experts across the world started using the term 'optimum' in place of the hitherto used term 'maximum'.

4. Michael P. Todaro, ***Development Planning: Models and Methods.*** Oxford Univ. Press, Nairobi, 1971.
5. United Nations Department of Economic Affairs, ***Measures for Economic Development of Underdeveloped Countries,*** UNO, DEA, New York, 1951, p. 63.
6. ***First Five Year Plan (1928–33),*** The Gosplan, USSR, 1928.
7. Many of the PSUs in 1950s and the early 1960s were not only set up with natural resources (capital as well as the machines) from USSR, Germany, etc. but even the human resource was also tapped from there for few years.
8. Though the USA was the first to go for planning-but at the regional level (Tennessee Valley Authority, 1916)—it never announced its any intention of national planning.
9. Leong, G.C. and Morgan, G.C., ***Human and Economic Geography,*** Oxford University Press, Oxford, 1982., p. 145.
10. Alec Nove, ***An Economic History of the USSR,*** 3rd ed., Penguin Books, Baltimore, USA, 1990, p. 139.
11. Rakesh Mohan, ***Industrial Policy and Controls*** in the Bimal Jalan edited ***The Indian Economy: Problems and Prospects,*** Penguin Books, N. Delhi, 2004., p. 101. Also see Bipan Chandra et. al., ***India After Independence,*** Penguin Books, N. Delhi, 2000, pp. 341–342 as well as A. Vaidyanathan, ***The Indian Economy Since Independence (1947–70)*** in Dharma Kumar (ed.), ***The Cambridge Economic History of India,*** Vol. II, Cambridge University Press, Cambridge, 1983, pp. 949–50.
12. Samuelson, P.A. and Nordhaus, W.D, ***Economics,*** McGraw-Hill Companies Inc., N. York, 2005., p. 591.
13. From Poland two great economists Oskar Lange (1904–65) and Michal Kalecki (1899–1970); from Hungary, William J. Fellner (1905–83), Nicholas Kaldor (1908–86), Thomas Balogh (1905–85) and Eric Roll (1907–95); from postwar Austria Ludwig von Mises (1880–1973), Friedrich A. von Hayek (1899–1992), Fritz Machlup (1902–83), Gottfried Haberler (1900–96) and Joseph A. Schumpeter (1883–1950) [J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1987, pp. 187–190].
14. It was blasphemous to preach in favour of market in the socialist world at that time—he was not put behind the bars was a great mercy on him. Oskar Lange towards the end of his life told Paul M. Sweezy, the most noted American Marxist scholar, that during this period he did not retire for the night without speculating as to whether he might be arrested before the dawn (J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1987, p. 189).
15. ***Collins Internet-linked Dictionary of Economics***, Glasgow, 2006.
16. Steiner, ***Government's Role in Economic Life,*** McGraw-Hill, New York, 1993, p. 152.
17. India had a French influence on its development planning when it followed almost state monopoly in the six infrastructure industries also known as the ***core*** or the ***basic*** industries i.e. cement, iron and steel, coal, crude oil, oil refinery and electricity.
18. Though the planning agencies the National Economic Development Council (NEDC) and the Economic Development Committees (EDCs) continued functioning, it was in 1992 that the NEDC was abolished (***Collins Dictionary of Economics, op.cit.***).

5

PLANNING IN INDIA

*For the first eight Plans the emphasis was on a growing public sector with massive investments in basic and heavy industries, but since the launch of the Ninth Plan in 1997, the emphasis on the public sector has become less pronounced and the current thinking on planning in the country, in general, is that it should increasingly be of an indicative nature.**

- Introduction
- Background
- Major Objectives of Planning
- Planning Commission
- National Development Council
- Central Planning
- Multi-Level Planning
- Way to Decentralised Planning
- The Planning Commission & the Finance Commission
- The Changing Nature and Role of Planning
- Monitorable Targets Set by the 12the Plan
- A Critical Evaluation

** Planning Commission, 'An Overview of Planning in India', GoI, N Delhi, 2013.*

INTRODUCTION

It was the Soviet Union which explored and adopted *national planning* for the first time in the world. After a prolonged period of debate and discussion, the First Soviet Plan commenced in 1928 for a period of five years. But the world outside was not fully known to the modus operandi of development planning till the 1930s. It was the exodus[1] of the east European economists to Britain and the United States in 1920s and 1930s that made the world aware as to what economic/national planning was all about.The whole lot of colonial world and the democracies of the time were fascinated by the idea of planning as an instrument of economic progress. The nationalist leaders with socialistic inclination of the erstwhile British colonies were more influenced by the idea of economic planning. The whole decade of 1930s is the period in the Indian history when we see nationalists, capitalists, socialists, democrats and academicians advocating for the need of economic planning in India at one point or another.[2]

Independent India was thus destined to be a planned economy. The economic history of India is nothing but the history of planning[3] . Even if the so-called economic reforms started in 1991–92, all the humble suggestions regarding the contours of reforms were very much outlined by the Planning Commission by then.[4] Once the reforms commenced, the think tank started outlining the major future direction for further plans.[5] Going through the history of planning in India is a highly educational trip in itself—for though the planning commission has been a political body, it never hesitated in pointing out good economics time and again. Let us therefore look into the unfolding of the planning process in India.

BACKGROUND

By the decade of 1930s, the idea of planning had already entered the domain of intellectual and political discussion in India. Many fresh proposals suggesting immediacy of planning in India were put forward though the erstwhile British Government remained almost immune to them. But these humble proposals of planning served their purpose once independent India decided to adopt a planned economic pattern for India of which a list is given below:

The Visvesvaraya Plan

The credit of proposing the first blueprint of Indian planning is given to the popular civil engineer and the ex-Dewan of Mysore state M. Visvesvaraya—in his book *The Planned Economy of India,* published in 1934.[6] His ideas of state planning were an exercise in democratic capitalism (similar to the USA) with emphasis on industrialisation—a shift of labour from the agrarian set up to the industries targeting to double national income in one decade. Though there was no follow up by the British Government on this plan, it aroused an urge for national planning among the educated citizens of the country.

The FICCI Proposal

In 1934, a serious need of national planning was recommended by the Federation of Indian Chambers of Commerce and Industry (FICCI), the leading organisation of Indian capitalists. Its President N.R. Sarkar proclaimed that the days of undiluted laissez-faire were gone forever and for a backward country like India, a comprehensive plan for economic development covering the whole gamut of economic activities was a necessity. Voicing the view of the leadership of the capitalist class he further called for a high powered 'National Planning Commission' to coordinate the whole process of planning so that the country could make a structural break with the past and achieve its full growth potential.[7]

By the late nineteenth century, the economic thinking of the nationalists (such as M.G. Ranade and Dadabhai Naroji) was in favour of a dominant role of state in the economy and doubted the prudence of the 'market mechanism'. This thinking was further reinforced by the Keynesian ideas in the wake of the Great Depression, the *New Deal* in the USA and the Soviet experiment in national planning. Thus the Indian capitalist class were also influenced by these events which were voiced in the FICCI articulation for the planning.

The Congress Plan

Though the Gandhians and some of the business and propertied representatives were opposed to commit the party to centralised state planning (including Mahatma Gandhi)[8], it was on the initiative[9] of the INC president Subhash C. Bose that the National Planning Committee (NPC) was set up in October 1938 under the chairmanship of J.L. Nehru to work out concrete programmes for development encompassing all major areas of the economy. Basically, the NPC was set up in a conference of the Ministers of Industries of the Congress-ruled States (though other states were also invited to participate) where M. Visvesvaraya, J.R.D. Tata, G.D. Birla and Lala Sri Ram and many others including academicians, technocrats, provincial civil servants, trade unionists, socialists and communists etc. were also invited. The 15-member NPC with 29 sub-committees and a total of 350 members produced 29 volumes of recommendations.[10] The work of the committee was interrupted when the Second World War broke out and in the wake of the Quit India Movement many of its members including the chairman were arrested, and between 1940 and 1945 the Committee had only a nominal existence. Though the final report of the NPC could only be published in 1949, many developments related to planning took place during the Interim Government upto 1946.

"A series of valuable reports were published which brought together the constructive thinking done by the committee and the sub-committees and the material collected in the course of their work. The importance of the NPC lies not so much in these reports as in the wide interest it created throughout the country for co-ordinated planning as the only means of bringing about a rapid increase in the standards of living and its emphasis on the need for bringing fundamental changes in the social and economic structure."[11]

Some of the important developments after the NPC was set up which prepared a foundation for the coordinated planning in independent India are given below:

(i) ***Post War Reconstruction Committee:*** Early in June 1941, the Government of India formed (on popular demand) a Post-War Reconstruction Committee which was to consider various plans for the reconstruction of the economy.[12]

(ii) ***Consultative Committee of Economists:*** A consultative committee of economists under the chairmanship of Ramaswamy Mudaliar was set up in 1941 as a 'think tank' to advise the four Post-War Reconstruction Committees for executing, national plan for the country.

Though the committee suggested many plans for the different areas of the economy but they had negligible practical significance and had all the academic biases of the committee.

(iii) ***Planning and Development Department:*** After all possible delays, it was in 1944 that the Government created a Planning and Development Department under a separate member of the Viceroy's Executive Council for organising planning work in the country and co-ordinating it. Ardeshir Dalal (the controller of the Bombay Plan) was appointed as one of its acting members. More than 20 panels of experts were set up. The central departments and the Governments of Provinces and Indian States were invited to prepare detailed plans for industrialisation.[12] This Department was abolished in 1946.

(iv) ***Advisory Planning Board:*** In October 1946, the Government of India appointed a committee called the 'Advisory Planning Board'[13] to review the planning that had already been done by the British Government, the work of the National Planning Committee, and other plans and proposals for planning and to make recommendations regarding the future machinery of planning and also in regard to objectives and priorities. The Board strongly recommended the creation of "a single, compact authoritative organisation .... responsible directly to the Cabinet ... which should devote its attention continuously to the whole field of development."[14] This was an emphatic advice for the creation of a National Planning Commission, similar to the FICCI's view of 1934, which will have autonomy and authoritative say on the process of development planning, working in tandem with the Union cabinet and influencing the developmental decisions of the states, too. This happened in 1950 with the setting up of the Planning Commission.

The Board, in its Report of January 1947, emphatically expressed the opinion that the "proper development of large-scale industries can only take place if political units, whether in the provinces or states, agree to work in accordance with a common plan."[15] This suggestion worked as a great influence on the planning process of independent India as it always tried to give unifying nature to development planning. But, this process also induced a serious tendency of centralisation in the Indian planning to which a number of states were to pose objections and therely straining the centre-state relations, time and again.[16] However, the political leadership right since 1920s was very conscious of the need for decentralised planning in the country.[17]

The Bombay Plan

Bombay Plan was the popular title of 'A Plan of Economic Development for India' which was prepared by a cross-section of India's leading capitalists. The eight capitalists involved in this plan were Purshotamdas Thakurdas, J.R.D. Tata, G.D. Birla, Lala Sri Ram, Kasturbhai Lalbhai, A.D. Shroff, Avdeshir Dalal and John Mathai.[18] The Plan was published in 1944–45. Out of these eight industrialists, Purshotamdas Thakurdas was one among the 15 members of the National Planning Committee (1938)[19]. Rest three J.R.D. Tata, G.D. Birla and Lala Sri Ram, were the members of the sub-committees (29 in total) of the National Planning Committee.[20]

The popular sentiments regarding the need of planning and criss-cross of memberships between the NPC and the Bombay Plan club made possible some clear-cut agreements between these two major plans which ultimately went to mould the very shape of the Indian economy after independence. We may have a look at some of the very important agreements:[21]

(i) A basic agreement on the issue of the ***agrarian restructuring***—abolition of all intermediaries (i.e Zamindari Abolition), minimum wages, guarantee of minimum or fair prices to agricultural producers, cooperatives, credit and marketing supports.

(ii) Agreement on ***rapid industrialisation*** for which both the plans agreed upon an emphasis on heavy capital goods and basic industries (the Bombay Plan had allocated 35 per cent of its total plan outlay on basic industries).

(iii) Taking clues from the Soviet Planning, the NPC and the Bombay Plan both were in favour of a simultaneous ***development of the essential consumer goods*** industries but as a low-key affair.

(iv) Both the Plans agreed upon the importance of promoting the ***medium-scale, small-scale*** and ***cottage industries*** as they could provide greater employment and require lesser capital and lower order of plants and machineries.

(v) Both the Plans wanted the ***state to play an active role*** in the economy through planning, controlling and overseeing the different areas of the economy i.e. trade, industry, banking through state ownership (public sector) or through direct and extensive control over them.

(vi) Large-scale measures for ***social welfare*** were favoured by both the plans which suggested to be based on issues like, right to work and full employment, the guarantee of a minimum wage, greater state expenditure on housing, water and sanitation, free education, social insurance to cover unemployment and sickness and provision of utility services such as electricity and transportation at a low cost through state subsidies.

(vii) Both the Plans agreed upon a planning which could do away with the gross ***inequalities.*** Through measures like progressive taxation, and prevention of concentration of wealth. Inequality was considered undesirable as it tended to restrict the domestic market.

The Gandhian Plan

Espousing the spirit of the Gandhian economic thinking, Sriman Narayan Agarwal formulated this plan in 1944. This plan laid more emphasis on agriculture. Even if he referred to industrialisation it was to the level of promoting cottage and village-level industries, unlike the NPC and the Bombay Plan which supported a leading role for the heavy and large industries. The plan articulated a ‘decentralised economic structure’ for India with ‘self-contained villages’.

It needs to be noted here that the Gandhians did not agree with the views of the NPC or the Bombay Plan, particularly on issues like centralised planning, dominant role for state in the economy and the emphasis on industrialisation being the major ones.[22] For Gandhi, the machinery, commercialisation and centralised state power were the curses of modern civilisation, thrust upon the Indian people by European colonialism. It was industrialism itself, Gandhi argued, rather than the inability to industrialise, which was the root cause of Indian poverty. This was until the 1940s that the Congress supported the above-given view of Gandhi to mobilise a mass movement against the colonial rule.

But it was in the NPC that the Congress tried to articulate a different view on these issues, almost taking a break from Gandhi's ideas. The very first session of the NPC was brought to an impasse by J.C. Kumarappa (the lone Gandhian on the 15-member NPC) by questioning the authority of the NPC to discuss plans for industrialisation. He said on the occassion that the national priority as adopted by the Congress was to restrict and eliminate modern industrialism. The impasse was normalised after Nehru intervened and declared that most members of the NPC felt that large-scale industry ought to be promoted as long as it did not 'come into conflict with the cottage industries'.[23] This was a long-drawn ideological impasse which made it necessary to articulate the Gandhian view of planning via this plan.

The People's Plan

In 1945, yet another plan was formulated by the radical humanist leader M.N. Roy, chairman of the Post-War Reconstruction Committee of Indian Trade Union. The plan was based on Marxist socialism and advocated the need of providing the people with the 'basic necessities of life'.[24] Agricultural and industrial sectors, both were equally highlighted by the plan. Many economists have attributed the socialist leanings in Indian planning to this plan. The common minimum programmes of the United Front Government of the mid-nineties (20^{th} century) and that of the United Progressive Alliance of 2004 may also be thought to have been inspired from the same plan. 'Economic reforms with the human face', the slogan with which the economic reforms started early 1990s has also the resonance of the People's Plan.

The Sarvodaya Plan

After the reports of the NPC were published and the Government was set to go for the five-year Plans, a lone blueprint for the planned development of India was formulated by the famous socialist leader Jaiprakash Narayan—the Sarvodaya Plan published in January 1950. The plan drew its major inspirations from the Gandhian techniques of constructive works by the community and trusteeship as well as the Sarvodaya concept of Acharya Vinoba Bave, the eminent Gandhian constructive worker. Major ideas of the plan were highly similar to the Gandhian Plan like emphasis on agriculture, agri-based small and cottage industries, self-reliance and almost no dependence on foreign capital and technology, land reforms, self-dependent villages and decentralised participatory form of planning and economic progress, to name the major ones.[25] Some of the acceptable ideas of the plan got their due importance when the Government of India promoted five year plans.

By the early 1960s, Jayprakash Narayan had become highly critical of the Indian planning process especially of its increasing centralising nature and dilution of people's participation in it. Basically, the very idea of democratic decentralisation was disliked by the established power structure, namely, the MLAs/MPs, the bureaucracy and the state-level politicians.[26] This led the Jayprakash Narayan Committee (1961) to observe against the centralising nature of the Indian planning. The committee pointed out that after having accepted Panchayati Raj as the agency responsible for planning and execution of plans, there is "no longer any valid reason for continuing the individual allocations subjectwise even to serve as a guide."[27]

Disregarding the humble advice of the committee, central schemes like small farmers development

agency (SFDA), drought-prone area programme (DPAP), intensive tribal development programme (ITDP), intensive agricultural district programme (IADP), etc. were introduced by the Governments and were put totally outside the purview of Panchayats.

It was only after the 73rd and 74th Amendments effected to the Constitution (1992) that the role of local bodies and their importance in the process of planned development was accepted and the views of Jayprakash got vindicated.

Some Area-wise Reports

The idea for the need of a planned development of India became more and more popular by the decade of the 1940s. It was under this popular pressure that the Government of India started taking some planned actions in this direction. In the 1940s, we see several area-specific reports being published:[28]

- (i) Gadgil Report on Rural Credit
- (ii) Kheragat Report on Agricultural Development
- (iii) Krishnamachari Report on Agricultural Prices
- (iv) Saraiya Report on Cooperatives
- (v) A series of Reports on Irrigation (ground water, canal, etc.)

All these reports, though prepared with great care and due scholarship, the Government had hardly any zeal to implement plans on their findings. But independent India was greatly benefited when the planning started covering all these areas of concerns.

There is no doubt in drawing the conclusion that prior to independence, there was thus a significant measure of agreement in India between the Government of India under the Secretary of State, the Indian National Congress, prominent industrialists and the others on the following principles:[29]

- (i) There should be central planning, in which the state should play an active part, for social and economic development to bring about a rapid rise in the standards of living;
- (ii) There should be controls and licencing in order, among other things, to direct investments into the desired channels and ensure equitable distribution;
- (iii) While there should be balanced development in all sectors of the economy, the establishment of basic industries was specially important. In this, State-owned and state-managed enterprises have an inportant role. There were, however, differences of approach with regard to the specific fields to be allocated to the public and private sectors.

It is highly interesting and important to note that all the above agreements and opinions were reached through an evolutionary manner in the last two-decades before independence in the deliberations and excercises regarding the need for economic planning in the country.

"The plans prepared by the Governmnt of India, the Bombay Plan and other above-discussed plans (except the NPC and the Sarvodaya Plan) suffered from serious limitations. When they were prepared, it was known that transfer of power was to take place quite soon; but the exact form of the future government was not known, the plans consisted largely of proposals of experts which were not effectively co-ordinated. They had no social philosophy behind them. With the advent of independence, they became inadequate, though the thinking that had taken place on planning generally

and its techniques proved useful for the future."[30]

MAJOR OBJECTIVES OF PLANNING

Planning for India was an instrument to realise the aspirations and dreams of the future. We know that the foundations of future India were not laid in one day. The cherished dream about future India had evolved through a long-drawn process of the entire period of the freedom struggle. These aspirations and goals got their proper places and due importance in the reports of the National Planning Committee (NPC), in the deliberations of the Constituent Assembly and finally in the Constitution of India. From the margins of the ripening nationalist movement as well as taking clues from the Soviet and the French styles of planning, the NPC articulated the objectives of planning in India. The process of planning in India tried to include all the aspirations of nationalist movement as well as of the future generations. But this will be a highly general comment upon the objectives of planning in India. We need to delve into the specific and objective goals of planning in India to further our discussions. Some of the historic deliberations regarding planning will serve our purpose:

1. Reviewing the entire situation, in the light of the social philosophy evolved over decades, the Constituent Assembly came to the conclusion that to guide this 'revolution of rising expectations' into constructive channels, India should make determined efforts through carefully planned large-scale social and economic development and the application of modern scientific and technological improvements, to bring about a rapid and appreciable rise in the standard of living of the people, with the maximum measure of social justice attainable. On the whole it was a call for India becoming a Welfare state.[31] This important deliberation does not only call for the necessity of planning for the country but it also outlines the broader objectives of planning, too.

2. There are three important features included by the Constitutional provisions which pertain to the objectives of planning in the country:[32]

   (i) 'Economic and social planning' is a concurrent subject. Also, while framing the 'Union', 'State' and 'Concurrent' list, allocating subjects and other provisions, the Constitution vests power in the Union to ensure co-ordinated development in essential fields of activity while preserving the initiative and authority of the states in the spheres allotted to them.

   (ii) The Constitution includes provisions for promoting co-operation on a voluntary basis between the Union and the states and among states and groups of states in investigation of matters of common interest, in legislative procedures and in administration, thus avoiding the rigidities inherent in federal constitutions (Articles 249, 252, 257, 258, 258-A, and 312). In other words, the objective is co-operative federalism.

   (iii) The Constitution also sets out in broad outline the pattern of the welfare state envisaged and the fundamental principles on which it should rest.

These are the major cornerstones of planning and its objectives enshrined in the Constitution that will breed enough Union–State tussle in coming decades and make it compulsive for the Government to resort to 'reforms with a human face' rhetoric.We can see the methodology of planning taking a U-turn in the era of the economic reforms since early 1990s.

3. The Government resolution announcing the setting up of the Planning Commission (March 1950)

started with a reference to the constitutional provisions bearing on the socio-economic objectives of the Constitution. The Fundamental Rights and the Directive Principles of the Constitution assure every citizen, among other things, adequate means of livelihood, opportunities for employment and a socioeconomic order based on justice and equality. Thus, the basic objectives[33] of planning were already given in the provisions of the Constitution of India. These were emphatically stated in the First Five-Year Plan (1951–56) itself, in the following words:

"The urge to economic and social change under present conditions comes from the facts of poverty and of inequalities in income, wealth and opportunity. The elimination of poverty cannot obviously, be achieved merely by redistributing existing wealth. Nor can a programme aiming only at raising production remove existing inequalities. These two have to be considered together......"

4. The above objectives of planning were emphasised in one form or the other in the coming times also. As the Second Five-Year Plan (1956–61) said:

"The Plan has to carry forward the process initiated in the First Plan period. It must provide for a larger increase in production, in investment and in employment. Simultaneously, it must accelerate the institutional changes needed to make the economy more dynamic and more progressive in terms no less of social than of economic ends."

5. The same objectives were repeated by the Sixth Five-Year Plan (1980–85) in the following words:

"The basic task of economic planning in India is to bring about a structural transformation of the economy so as to achieve a high and sustained rate of growth, a progressive improvement in the standard of living of the masses leading to eradication of poverty and unemployment and providing a material base for a self-reliant economy."

6. It will be highly needful to enquire about the objectives of planning in the era of the economic reforms initiated in the fiscal 1991–92 as this new economic policy (NEP) made the experts and economists to conclude many questionable things about the objectives of planning in the country:

(i) There did hd on the wage employments still, others based on self-employment.

(ii) The state is rolling back and the economy is becoming pro-private and sector-wise the social purpose of the planning will be lacking.

(iii) The objectives of planning nearly outlined hitherto have been blurred.

(iv) The promotion of foreign investment will induce the economy into the perils of neo-imperialism, etc.

But all the above-given doubts were cleared by the forthcoming plans in straightforward words. We may quote from the following Plans:

(i) "For the future economic development, the economy will be more dependent upon private participation and the nature of planning will become more indicative with the major objectives of planning remaining the same". This was announced by the Government while launching the economic reforms (July 23, 1991) and commencing the Eighth five-year Plan (1992–97). "There was no change in the basic objectives of planning even though there was change in instruments of policy"—this was announced by the Government while announcing the new economic policy (1991).

(ii) While the Ninth Plan (1997–2002) was being launched it was announced, "The goals of

planning in India, which were set by Panditji have not changed. The Ninth Plan does not attempt to reinvent the wheel. At the same time, the goals and targets this Plan attempts to achieve are based on the lessons of experience including the Eighth Plan. They address today's problems and challenges and try to prepare the nation for tomorrow as well."[34]

Finally, a broad consensus looks evolving through the process of planning and crystallising on the six major objectives of planning[35] in India which are as follows:

(i) **Economic Growth:** Sustained increase in the levels of production in the economy is among the foremost objectives of planning in India which continues till date and will be so in future, without any iota of doubt in it.

(ii) **Poverty Alleviation:** Poverty alleviation was the most important issue which polarised the members of the NPC as well as the Constituent Assembly that a highly emphatic decision in favour of a planned economy evolved even before independence. Several programmes have been launched in India directing the cause of poverty alleviation by all the Governments till date and the process continues even today with more seriousness (we see the National Rural Employment Guarantee Programme—NREGP—being launched by the UPA Government in 2006 by passing an Act in the Parliament—the matter has started attracting such high political concern!).

(iii) **Employment Generation:** Providing employment to the poor has been the best tool of economics to alleviate poverty. Thus, this objective of planning in India comes naturally once it commit0ted itself to alleviate poverty. Employment generation in India has been, therefore, part and parcel of the objective of poverty alleviation in India. General programmes and schemes have been launched by the Governments from time to time in this direction, some based on the wage employments still, others based on self-employment.

(iv) **Controlling Economic Inequality:** There were visible economic inequalities in India at the inter-personal as well as at the intra-personal levels. Economic planning as a tool of checking all kinds of economic disparities and inequalities was an accepted idea by the time India started planning.[36] To fulfill this objective of planning the Governments have enacted highly innovative economic policies at times even inviting a tussle with regard to the Fundamental Rights Constitution.

Though Indian Planning has socioeconomic objectives to fulfill, only economic planning was made a part of the planning process (technically speaking) and social planning (better called social engineering) was left to the political process. That is why reservation in government jobs and admissions in premier academic institutions, land reforms, promoting inter-caste marriages, etc. do not fall under the purview of the Planning Commission.

(v) **Self-reliance:** During the 1930s and 1940s, there was an ardent desire among the nationalists, capitalists and the NPC for making the economy self-reliant in every field of the economic sphere. Self-reliance was defined not as autarchy but as an effort to strike against a subordinate position in the world economy. As Jawaharlal Nehru asserted: self-reliance, "does not exclude international trade, which should be encouraged but with a view to avoid economic imperialism."[37] India still strives for self-reliance in every field of economy as well as serving the realities of higher interdependence in the globalising world post-World Trade Organisation (WTO).

(vi) **Modernisation:** Modernising the traditional economy was set as a foremost objective of the planning. Specially, the agriculture sector of the economy needed an immediate inclusion of modern methods and techniques of farming dairying, etc. Similarly, in education too, India needs to go for inclusion of modern education system.

India did not miss the chance of accepting the importance of modern science and technology. As the economy had selected industry as its prime moving force (PMF), it was essential to adopt the changing dimensions of science and technology.

The major objectives of planning in India are not only broad but open-ended. That is why it hardly needs any change and modification in them with the changing times. It means, after the completion of one plan the objectives for the new plan are automatically set. Coming to the composition of the objectives, we may confidently conclude that all the aspirations of the Preamble,[38] the Directive Principles of the State Policy,[39] the Fundamental Duties and the Fundamental Rights have got their due place and weightage. All the aspirations of the nationalists and the freedom fighters look resonating in the very soul of the Indian planning system.

The objective of planning in India was so broad a term that gradually it encompassed the entire sphere of administration excluding only defence and foreign affairs**.** The objectives of planning tremendously evolved and got cemented together once the functions of the Planning Commission were announced by the Government in 1950 itself and further expanded in 2002 (*which we will see in the next sub-title*).

PLANNING COMMISSION

Once the National Planning Committee published its Report (1949) and there was a firm inclusion of the need for 'Economic and Social Planning'[40] in the Constitution, the stage was set for the formal launching of planning in the country. Though the economy was run on the principles of planning very much after the independence itself[41] it was in a piecemeal manner only. For formal planning to begin, for the whole economy at national level, there was a need for a permanent expert body which could take over the responsibility of the whole gamut of planning i.e. plan formation, resource aspects, implementation and review—as planning is a technical[42] matter. Thus, in March 1950[43] the Planning Commission (PC) was set up by the Government by Cabinet Resolution (without resorting to legislation). Important details regarding the composition, legal status, etc. of the PC are as under:

(i) A n ***extra-constitutional*** (i.e. non-constitutional) and ***non-statutory*** body (though planning originates from the Constitution there is no reference to the PC in it).

(ii) An ***advisory body*** to the Government of India on an array of issues of economic development.

(iii) A 'think tank' on economic development with the Prime Minister as its ex-officio Chairman and with the provision or a Deputy Chairman.[44] The main function of the Deputy Chairman is to ***co-ordinate*** the work of the Commission.[45]

(iv) Has an open provision for the number of its membership (as many area experts are required by the particular proposed period of planning) other than six Union Cabinet Ministers as its ***ex-officio members***[46] and a Member Secretary. The Minister of Planning is already an ex-

officio member of the PC.[47]

(v) An ***autonomous body*** entitled to form its own views on important issues and place them before the governments. It works closely with the Union and State cabinets and has full knowledge of their policies.[48]

(vi) Is invariably ***consulted*** on changes proposed in social and economic policies. To ensure free and full exchange of ideas, the P.C has established a ***convention*** that it will not give publicity to differences of views between the Commission and the Union and State Governments.[48]

(vii) ***Linked*** with the Union Cabinet at the secretariat level. The PC is part of the Cabinet organisation and the 'demand for grants' for it is included in the budget demand for the Cabinet Secretariat.[48]

(viii) Seated at the 'Yojana Bhavan', the Commission has a staff of Secretaries and Advisers and also a research organisation.[48]

(ix) The PC is a ***technical body*** with experts and professionals coming from an array of specific areas as per the need of planning of the concerned period.(see Reference 42).

(x) The Commission has ***executive powers.***[49]

Functions of the PC

Though the PC was set up with a definite purpose of planning, nobody knew that it would extend its functions over the entire spectrum of administration in the country. It was described as the 'economic Cabinet of the country as a whole' even encroaching upon the constitutional body like the finance commission[50] and not being accountable to the parliament.[51] Through time it built up a heavy bureaucratic organisation[52] which led even Nehru himself to observe— "The Commission which was a small body of serious thinkers has turned into a government department complete with a crowd of secretaries, directors and of course a big building."[53]

Though the functions of the PC were extended to include timely changes in the planning needs (in the reforms era), its functions were announced by the same government order which did set up the Planning Commission, itself. The order[54] says:

"The Planning Commission will—

(i) Make an assessment of the material, capital and human resources of the country, including technical personnel, and investigate the possibilities of augmenting such of those resources as are found to be deficient in relation to the nation's requirements;

(ii) Formulate a plan for the most effective and balanced utilisation of the country's resources;

(iii) On a determination of priorities, define the stages in which the plan should be carried out and propose the allocation of resources for the due completion of each stage;

(iv) Indicate the factors which are tending to retard economic development, and determine the conditions which, in view of the current social and political situation, should be established for the successful execution of the plan;

(v) Determine the nature of the machinery which will be necessary for securing the successful implementation of each stage of the plan in all its aspects;

(vi) Appraise from time to time the progress achieved in the execution of each stage of the Plan and recommend the adjustments of policy and measures that such appraisal may show to be necessary; and

(vii) Make such interim or ancillary recommendations as appear to be appropriate either for facilitating the discharge of the duties assigned to it; or on a consideration of the prevailing economic conditions, current policies, measures and development programmes; or on an examination of such specific problems as may be referred to it for advice by Central or State Governments."

With the commencement of the Tenth Plan (2002–07), the Government handed over ***two new functions*** to the planning commission in 2002, namely-

(i) To monitor the plan implementation with special reference to the process of 'economic reforms' with the help, of the steering committees.

It should be noted here that once the process of economic reforms was initiated in the country (early 1990s) there was a diminishing role proposed for the state in the economy in some areas and increased role for it in some other areas. The re-definition of the state's role in the economy (though it was the contemporary thinking world wide) made most of the experts and the business community to conclude as if there will be no role for planning in the economy. The New Economic Policy (NEP) of 1991–92 was a prima-facie proposal for the expansion of the market economy in the country. But it was not the case altogether. The planning has not become irrelevant though it needed to search for a new orientation. And it was highly essential that the process of planning keeps its relevance to the bigger and the broader process of economic reforms. This particular new function of the PC must be seen in this light.

(ii) To monitor the progress of various Central Ministries. It should be noted here that for the first time, the PC went to set the 'monitorable targets' for ten areas indicating development. The Central Ministries have been linked to these monitorable targets. The timely performances of the Ministries are now monitored by the PC as per its new fuction.

With the inclusion of the above-mentioned two functions in the existing functions (which were already very broad), the PC has emerged as a real 'supercabinet'. Since it is basically the Deputy-Chairman who officiates the general meetings of the commission, he has a high-level say[55] in articulating the direction and the nature of the economic policies. Through the first new function it articulates the future dimensions of the economic reforms and through the second new function, it influences the works of the various Ministries—ultimately it seems as if the PC has been able to emerge as the real think-tank of development in the country.[56]

The PC has also been able to influence the states economic policies since 2002 in a great way. Though the PC today does not make the state plans[57] it is able to influence the overall economic policies of the states. It has been possible due to the setting of 'monitorable targets' for states for the same development indicators/areas as has been set for the Centre.[58] The states are liable for being monitored by the PC concerning their performances regarding these monitorable targets. This way the Central Government has started having its say over the state governments via the new functions of the PC.

We may conclude that the PC has been able to unify not only the various economic policies of the

centre but also those of the states with the help of these two new functions given to it. Earlier, there had always been a lack of congruence among the policies of the various central ministries and the ideas articulated by the PC.

NATIONAL DEVELOPMENT COUNCIL

The National Development Council (NDC) was set up in August 1952, by a Resolution[59] issued from the cabinet secretariat. The first Plan recommended its formation with a very concise and suitable observation[60] about it:

"In a country of the size of India where the states have under the constitution full autonomy within their own sphere of duties, it is necessary to have a forum such as a National Development Council at which, from time to time, the Prime Minister of India and the Chief Ministers of the states can review the working of the plan and of its various aspects."

There were some strong reasons why the NDC was set up which may be seen as follows:

(i) The Central Plans were to be launched in the states and the UTs with the participation of the state level personnel. The as the Planning Commission was not provided with its own implementation staff (though the PC was given the responsibility of plan implementation) for this purpose. Therefore, the consent and co-operation of these federal units was a must.

(ii) Economic Planning as a concept had its origin in the centralised system (i.e. Soviet Union). For India, to democratise/decentralise the very process of planning was not a lesser task/challenge than promoting development itself. Indian planning is rightly said to be a process of trial and error in striking a balance between liberty and progress, central control and private initiative and national planning with local authority.[61]

The setting up of the NDC can be considered as the step in India towards decentralised planning.

(iii) In the constitutional design of the federal rigidities it was necessary to provide the whole planning process a unified outlook. The NDC serves the purpose of diluting the autonomous and rigid federal units of the Union of India.[62]

The basic nature, legal status and other details of the NDC are same except its composition and functions. It is composed of all the members of the PC, the Union Cabinet, the Chief Ministers of the States, the Administrators/Lt. Governors of the Union Territories (UTs). The PM, naturally, chairs its meetings. The cabinet Resolution by which the NDC was set up defines its functions[63] which are as under:

(i) to consider the proposals formulated for Plans at all important stages and accept them;

(ii) to review the working of the Plans from time to time;

(iii) to consider the important questions of social and economic policy affecting national development; and

(iv) to recommend measures for the achievement of the aims and targets set out in the national Plan, including measures to secure the ***active participation*** and co-operation of the people, improve the efficiency of the administrative services, ensure the fullest development of the less advanced regions and backward sections of the community and through sacrifices borne

equally by all citizens, build up resources for national development.[64]

Though the first Plan of India was launched before the arrival of the NDC, the body had many meetings before the terminal year of the plan and useful deliberations (almost all) after due consideration were included by the Government into the planning process. But after the death of J.L. Nehru—the greatest champion of the democratic decentralisation in the country[65] the NDC had become a small gathering of only those who had the same vested interests with only the Congress CMs participating in its meetings. The CMs belonging to other political parties usually did not come to its meetings the Government hardly gave any importance to their advice. A phase of tussle between the centre and the states started worsening from here onward with a degradation in principles of the ***co*-operative federalism,** with every five-year plan which followed. It was only by the mid-1990s that we see the revival of the lost glory of NDC as well as that of the spirit of decentralised planning. This has been possible due to three major reasons:

(i) In the era of the economic reforms, with greater dependence on the private capital made it necessary to allow states greater autonomy in economic matters. Once the WTO regime started it became an economic compulsion.

(ii) The enactment of the Constitutional Amendments 73rd and the 74th had made local level planning a constitutional compulsion.

(iii) And lastly it was the compulsion of coalition politics in the formation of the Union Governments which made the centre to favour the states.

As per the major experts on the issue of decentralised planning, the last of the above given three reasons has played the most important role. After a long-long time, two plans (*the Tenth and the Eleventh*) were passed by the NDC with complete support coming from the CMs.

It is believed that as the local-level planning (i.e. the gram panchayat and the urban municipalities and corporations) allows more and more scope of planning by the states, the NDC will be able to function on its more original principles. The contemporary concerns of the Governments give enough hope to think like this, at least it seems so.

CENTRAL PLANNING

The Plans which are formulated by the Central Government and financed by it for the implementation at the national level are known as Central Plans. Over the years, the Centre has launched three such plans and the Governments have maintained continuity in their implementation. The three central plans are:

A. Five-Year Plans,

B. Twenty-Point Programme, and

C. Member of Parliament Local Area Development Scheme.

An introductory description of these plans is given as follows:

A. The Five-Year Plans

This is the most important among the central plans and is being continuously implemented one after the other since planning commenced in India. As planning has been a purely political excercise in India, the Five-Year Plans of the country have seen many unstable and critical moments till date. Several new developments related to planning also took place during the years. Given below is a concise summary of the Plans as we see their different periods of implementation:

First Plan:

The period for this plan was 1951–56. As the economy was facing the problem of large-scale foodgrains import (1951) and the pressure of price rise, the plan accorded the highest priority to agriculture including irrigation and power projects. About 44.6 per cent of the plan outlay went in favour of the public sector undertakings (PSUs).

The Plan was launched with all the lofty ideas of socio-economic development which had frustrating outcomes in the following years.

Second Plan:

The plan period was 1956–61. The strategy of growth laid emphasis on rapid industrialisation with a focus on heavy industries and capital goods.[66] The plan was developed by Professor Mahalanobis. Due to the assumption of a closed economy, shortages of food and capital were felt during this Plan.

Third Plan:

The Plan period was 1961–65. The Plan specifically incorporated the development of agriculture[67] as one of the objectives of planning in India besides for first time considering the aim of balanced, regional development.

Enough misfortunes a waited this plan—two wars, one with China in 1961–62 and the other with Pakistan in 1965–66 along the Gujarat border and a severe drought-led famine in 1965–66 had to be faced. Due to heavy drain and diversion of funds, this plan utterly failed to meet its targets.

Three Annual Plans:

The period of the three consecutive Annual Plans was 1966–69. Though the Fourth Plan was ready for its implementation in 1966, the weak financial situation as well as the low morale after the defeat by China, the Government decided to go for an Anuual Plan for 1966–67. Due to the same reasons the Government went for another two such plans in the forthcoming years. The broader objectives of these Annual Plans were inside the design of the Fourth Plan which would have been implemented for the period 1966–71 had the financial conditions not worsened by then.

Some economists as well as the opposition in the Parliament called this period as a discontinuity in the planning process, as the Plans were supposed to be for a period of five years. They named it a period of “Plan Holiday”, i.e. the planning was on a holiday.[68]

Fourth Plan:

The Plan period was 1969–74. The Plan was based on the Gadgil strategy with special focus to the ideas of growth with stability and progress towards self-reliance. Droughts and the Indo-Pak War of 1971–72 led the economy to capital diversions creating financial crunch for the Plan.

The politicisation of planning started from this plan which takes serious 'populist' design in the coming plans. Frequent double-digit inflations, unreigned increase in the fiscal deficits, subsidy-induced higher non-plan expenditures and the first move in the direction of 'nationalisation' and greater control and regulation of the economy were some of the salient features of this plan which continued unchanged till the early 1990s. The search for political stability at the centre converted planning into a tool of real politics with greater and greater 'centralisation' ensuing plan after plan.

Fifth Plan:

The Plan (1974–79) has its focus on poverty alleviation and self-reliance.[69] The popular rhetoric of poverty alleviation was sensationalised by the Government to the extent of launching a fresh plan i.e the Twenty-point Programme (1975) with a marginal importance being given to the objective of 'growth with stability' (one of the major objectives of the Fourth Plan).

The planning process got more politicised. The havocs of hyper-inflation led the Government to hand over a new function to the Reserve Bank of India to stabilise the inflation (the function which the RBI carries forward even today). A judicious price wage policy was started to check the menace of inflation on the wage-earners. This Plan saw an increase in the socio-economic and regional disparities despite the many institutional, financial and other measures which were initiated by the Government to attend them. The nationalisation policy continued. There was an overall decay in the quality of 'governance'. A nexus of the 'criminal-politician-bureaucrat' seems to emerge for the first time to hijack the political system.[70]

The plan period was badly disturbed by the draconian emergency and a change of the government in the centre. The Janata Party came to power with a thumping victory in 1977. As the government of the time had then complete say in the central planning in India how could the new Government continue with the Fifth Plan of the last Government which had still more than one year to reach its completion. The dramatic events related to Indian planning may be seen objectively as given below:

(i) The Janata Government did cut-short the Fifth Plan one year ahead of its terminal year i.e. by the fiscal 1977–78. in place of the decided 1978–79.

(ii) A fresh Plan, the Sixth Plan for the period 1978–83 was launched by the new Government which called it the **'Rolling Plan'.**[71]

(iii) In 1980, there was again a change of government at the centre with the return of the Congress which abandoned the Sixth Plan of the Janata Government in the year 1980 itself.

(iv) The new Government launched a fresh new **Sixth Plan** for the period 1980–85. But by that time, two financial years of the Janata Government's Sixth Plan had already been completed. These two years of the Plan were adjusted by the Congress Government in a highly interesting way:

   (a) The first year i.e 1978–79 was added to the fifth plan which was cut-short by the Janata Government to four years. And thus the Fifth Plan officially became of 5 years again (1974–79).

(b) Now what to do with the second year i.e. 1979–80. The Congress Government announced this year to be a year of one Annual Plan. This Annual Plan (1979–80) may be considered the lone independent remnant of the 'Rolling Plan' of the Janata Government.

The Sixth Plan (1978–83) which could not become an official plan of India had emphasis on some of the highly new economic ideas and ideals with almost a complete no to foreign investment; new thrust on the price control; rejuvenation of the Public Distribution System (PDS); emphasis on small scale and the cottage industries; new lease of life to the Panchayati Raj Institutions (i.e. the 2nd Phase of the frevival of the PRIs); agriculture and the subject of rural development getting the due; etc. being the major ones.

Sixth Plan

This Plan (1980–85) was launched with the slogan of '*Garibi Hatao*' (alleviate poverty).[72] Already, a programme (the TPP) was tested and tried by the same Government in the Fifth Plan which tried to improve the standard of living of the poor masses with the 'direct approach' (the idea of poverty alleviation but such a slogan of '*Garibi Hatao*' was not given to the programme).

Some of the major issues addressed by the Plan were—emphasis on socioeconomic infrastructure in the rural areas; eliminating rural poverty and reducing regional disparities through the IRDP (1979); 'target group'[73] approach initiated; a number of national level programmes and schemes were launched during the plan which tried to attend to the specific areas and the specific concerns of socioeconomic development (this is 'target group' approach):[74]

- National Rural Employment Programme (NREP)—1980
- Restructured Twenty-Point Programme–1982
- Biogas Programme—1982
- Development of women and children in Rural Areas (DWERA)—1983
- Rural Landless Employment Guarantee Programme (RLEGP)—1983
- Self-Employment to Educated Unemployed Youth Programme (SEEUP)—1983
- Dairy Development Programme (DDP)—1983
- Village and Small Industries Development Programme (VSIDP)—1983
- Tribal Development Agency (TDA)—1983
- Village and Small Industries Development Programme (VSIDP)—1983.
- Tribal Development Agency (TDA)—1983.
- National Seeds Programme (NSP)—1983.
- Intensive Pulses Development Programme (IPDP)—1983.
- Intensive Cotton Development Programme (ICDP)—1983.
- Khadi and Village Industries Programme (KVIP)—1983
- Programme for Depressed Areas (PDA)—1983.
- Special Programme for Women and Children (SPWC)—1983

Seventh Plan:

The Plan (1985–90) emphasised on rapid foodgrain production, increased employment creation and productivity in general. The basic tenets of planning i.e. ***growth, modernisation, self-reliance*** and ***social justice*** remained as the guiding principles.[75] The *Jawahar Rojgar Yojana* (JRY) was launched in 1989 with the motive to create wage-employment for the rural poors. Some of the already existing programmes such as the IRDP, CADP, DPAP and the DDP were re-oriented.

Till date, the Government has been evaluating the achievements of all the Developmental programmes, courtesy the youngest PM of India. Somehow, democracy and development got connected with a major change in the thinking of the political elite whichf decided to go in for democratic decentralisation to promote development. It laid strong foundations for itself as the constitutional Amendments—the 73rd and 74th were possible by the early 1990s.

Though the economy had better growth rates throughout the 1980s, specially in the latter half, yet it was at the cost of bitter fiscal imbalances. By the end of the Plan, India had a highly unfavourable balance of payments situation. Heavy foreign loans on which the governmental expenditures depended heavily during the period, the economy failed to service.[76] The Plan was not laid with a strong financial strategy which put the economy into a crisis of unsustainable balance of payments and fiscal deficits.[77] India basically tried to attend its growth prospects by commercial and other external borrowings on hard terms which the economy failed to sustain. In the process of liberalisation, an expansion of internal demand for the home market was permitted without generating equitable levels of exports and ultimately Indian imports were financed by the costly external borrowings. Such an 'inward looking' fiscal policy proved to be a mistake when the external aid environment for the economy was deteriorating.[78]

Two Annual Plans:

The Eighth Plan (whose term would have been 1990–95) could not take off due to the 'fast-changing political situation at the Centre'.[79] The pathbreaking and restructuring-oriented suggestfions of the Eighth Plan, the sweeping economic reforms ensuing around the world as well as the fiscal imbalances of the late 1980s were the other important reasons for the delay in the launch of the Eighth Plan. The new Government, which assumed power at the centre in June 1991, decided to commence the Eighth Plan for the period 1992–97 and that the fiscals 1990–91 and 1991–92 should be treated as two separate Annual Plans. The two consecutive Annual Plans (1990–92) were formulated within the framework of the approach to the Eighth Plan (1990–95) with the basic thrust on maximisation of employment and social transformation.

Eighth Plan:

The Eighth Plan (1992–97) was launched in a typically new economic environment. The economic reforms were already started (in July 1991) with the initiation of the structural adjustment and macro-stabilisation policies necessitated by the worsening Balance of Payments (BoP), higher fiscal deficit and unsustainable rate of inflation.

This was the first plan which went on for an introspection of the macro-economic policies which the country had been pursuing for many decades. The major concerns and pathbreaking suggestions[80] which this Plan articulated may be summarised as follows:

(i) an immediate re-definition of the state's role in the economy was suggested;[81]

(ii) 'market-based' development advised in the areas which could afford it i.e., a greater role for the private sector in the economy;[81]

(iii) more investment in the infrastructure sector specially in the laggard states as the ongoing emphasis on greater private sector investment could not be attracted towards these states;

(iv) rising non-plan expenditure and fiscal deficits need to be checked;

(v) subsidies need restructuring and refocussing;

(vi) planning immediately needs to be 'decentralised';

(vii) special emphasis on 'co-operative federalism' suggested;

(viii) greater focus on 'agriculture' and other 'rural activities' was suggested for which the Plan cited empirical evidences as they encourage the economy to achieve enhanced standard of living for its people and to promote the cause of balanced growth, a shift in the mindset of planning.

As the economy moved towards liberalisation, criticism came from every quarter against the move. The process of planning was also criticised on the following counts:

(i) As economy moves towards the market economy, the planning becomes 'irrelevant';

(ii) When the state is 'rolling back', planning makes no sense;

(iii) Planning process should be 're-structured' in the era of liberalisation; and

(iv) There should be increased thrust on the 'social sector' (i.e. education, healthcare etc.)

Ninth Plan:

The Ninth Plan (1997–2002) was launched when there was an allround 'slowdown' in the economy led by the South East Asian Financial Crisis (1996–97). Though the liberalisation process was still criticised, the economy was very much out of the fiscal imbroglio of the early 1990s. With a general nature of the 'indicative planning' the Plan not only did target an ambitious high growth rate (7 per cent) but also tried to direct itself towards time-bound 'social' objectives. There was an emphasis on the seven identified Basic Minimum Services (BMS) with additional Central Assistance for these services with a view of obtaining complete coverage of the population in a time-bound manner. The BMS[82] included:

(i) Safe drinking water;

(ii) Primary health service;

(iii) Universalisation of primary education;

(iv) Public housing assistance to the shelter-less poor families;

(v) Nutritional support to children;

(vi) Connectivity of all villages and habitations; and

(vii) Streamlining of the public distribution system.

The issue of fiscal consolidation became a top priority for the Governments starting from this Plan, for the first time which had its focus on the following[83] related issues:

(i) Sharp reduction in the revenue deficit of the Government, including centre, states and the PSUs through a combination of improved revenue collections and control of inessential expenditures;

(ii) Cutting down subsidies, collection of user charges on economic services (i.e electricity, transportation, etc.), cutting down interest, wages, pension, PF, etc;

(iii) Decentralisation of planning and implementation through greater reliance on states and the Panchayat Raj Institutions (PRIs).

Tenth Plan:

The Plan (2002–07) commenced with the objectives which had greater participation of the NDC in their formulation. Some of the highly important steps were taken during the plan which undoubtedly points out a change in the planning policy mindset of the economy, major ones being:[84]

(i) Doubling per capita income in 10 years;

(ii) Accepting that the higher growth rates are not the only objective—it should be translated into improving the quality of life of the people;

(iii) For the first time the Plan went to set the 'monitorable tragets' for eleven select indicators of development for the centre as well as for the states;

(iv) 'Governance' was considered a factor of development;

(v) States' role in planning to be increased with the greater involvement of the PRIs;

(vi) Policy and institutional reforms in each sector i.e. reforms in the PSUs, legal reforms, administrative reforms, labour reforms, etc;

(vii) Agriculture sector declared as the prime moving force (PMF) of the economy;

(viii) Increased emphasis on the social sector (i.e education, health, etc.);

(ix) Relevance between the processes of economic reforms and planning emphasised; etc.

The Mid-term Appraisal of the Plan was approved by the NDC in June 2005. The assessment gives a mixed picture regarding its performance. As per the Appraisal, the country performed well in many areas and these gains needed to be consolidated but there were some important weaknesses also, which, if not corrected can undermine even the current performance level.[85]

Eleventh Plan:

The Plan targets a growth rate of 10 per cent and emphasises the idea of 'inclusive growth'. In the approach Paper, the Planning Commission shows its concern regarding realising the growth targets on account of the compulsions towards the Fiscal Responsibility and Budget Management Act. In recent times some aberrations in the economy have started to increase the Government concerns in meeting the Plan target of 10 per cent growth. The major concerns are:

(i) A higher inflation (above 6 per cent) led to the tightening of the credit policy forcing lower investment in the economy (which will lower the production);

(ii) A stronger rupee is making export earnings shrink fast;

(iii) Costlier foodgrains and other primary articles playing havoc for the poor masses;

(iv) Costlier oil prices becoming a burden for the national exchequer; etc.

Not only the Government but the Confederation of Indian industry (CII) as well as the World Bank expressed doubt in the Eleventh Plan realising the ambitious 10 per cent growth.

Eleventh Plan: Performance

The Planning Commission (PC) had attempted the mid-term appraisal of the Plan which was considered and approved by the National Development Council in July 2010. The appraisal document reviewed the developments and provided a comprehensive assessment of the performance of the economy during the Eleventh Plan period so far in different sectors, together with suggested mid course corrections. It has drawn attention to the problems in some selected areas and identified constraints that would be of relevance for the balance period of the Eleventh Plan and also for the Twelfth Plan. These include inter-alia:

(i) Restoring dynamism in agriculture,

(ii) Managing India's water resources,

(iii) Problems in achieving power generation targets,

(iv) Issues pertaining to urbanisation, and

(v) Special problems of Tribal Development.

In respect of *agriculture,* the Mid-Term Appraisal notes that though agriculture performance and the rate of growth in the Eleventh Plan is likely to be better than that in the Tenth Plan, it may, however, not reach the target of 4% per year. The need for attention to agriculture and other critical issues mentioned above would require *concerted action* by the Centre and the States.

The Review by the PC regarding the **Poverty Estimates** is also important when the issue has become a matter of debate in the country. The Planning Commission is the nodal agency for estimating poverty in the country both at national level and across the States. The Planning Commission estimates the poverty on the basis of poverty line defined in terms of monthly per capita consumption expenditure. The Commission has been estimating poverty line and poverty ratio since 1997 on the basis of the methodology contained in the report of the Expert Group on 'Estimation of Number and Proportion of Poor' (known as *Lakdawala Committee Report*). The Head-count poverty ratio has been estimated by using the above mentioned poverty lines from a large size sample survey of household consumption expenditure carried out by the National Sample Survey Office with an interval of 5 years approximately.

The Planning Commission constituted an Expert Group in December, 2005 under the chairmanship of Prof. Suresh D Tendulkar to review the methodology for estimation of poverty. The Expert Group submitted its report in December 2009. While acknowledging the multi dimensional nature of poverty, the Expert Group recommended moving away from anchoring the poverty lines to the calorie intake norm, adopting the Mixed Reference Period (MRP) based estimates of consumption expenditure as the basis for future poverty lines, adopting MRP equivalent of urban Poverty Line Basket (PLB) corresponding to 25.7% urban headcount ratio as the new reference PLB for rural areas. On the basis of above methodology, the all-India rural poverty headcount ratio for 2004-05 was estimated at 41.8 %, urban poverty headcount ratio at 25.7% and all India level at 37.2%. It may however be mentioned that the Tendulkar Committee's estimates are not strictly comparable to the

present official poverty estimates because of different methodologies. As has been indicated in the Mid Term Appraisal of the Eleventh Five Year Plan, the revised poverty lines and poverty ratios for 2004-05 as recommended by the Tendulkar Committee have been accepted by the Planning Commission. The Tendulkar Committee has specifically pointed out that the upward revision in the percentage of rural poverty in 2004-05, resulting from the application of a new rural poverty line, should not be interpreted as implying that the extent of poverty has increased over time. These estimates, as reported by the Committee, clearly show that whether we use the old method or the new, the percentage of the population below poverty line has declined by about the same magnitude.

The performance on the **Fiscal Scenario**, according to the PC, the expansionary fiscal measures taken by the Government in order to counter the effects of the global slowdown were continued in 2009-10 and this led to further increase in the key deficit indicators. The fiscal deficit of the Centre which was 2.5% in 2007-08 increased substantially to 6.0% in 2008-09 and further to 6.4% in 2009-10 but it declined to 5.1% in 2010-11 (RE) and the Budget Estimates for 2011-12 put the fiscal deficit at 4.6% of the GDP. Similarly, the revenue deficit of the Centre increased from 1.1% in 2007-08 to 4.5% in 2008-09 and further to 5.2% in 2009-10 and declined to 3.4% for 2010-11 (RE). As per 2011-12 (BE), the revenue deficit is projected at the same level of 3.4% of GDP. The increase in the deficit levels of the Centre owes to revenue foregone on account of reduction in indirect tax rates and enhanced public expenditure in order to boost demand in the economy amidst global meltdown.

The issue of **Price Stability** remained resonating for more than half of the Plan Period. To ward off the crisis of rising prices, the Government needed to announce several tax concessions at one hand, while it could not pass the burden of the costlier imported oil prices on the masses. That would have resulted in ultimately putting the exchequer in a fund-crunch mode, at the end, creating a short-supply of investible funds in the government's hand, hence, causing the 11th Plan to perform at the levels below its target.

Twelfth Plan:

The Draft Approach Paper to the Twelfth Five Year Plan (2012-17) has been approved by the Cabinet. The theme of the approach Paper to the Twelfth Five year Plan is ***"faster, sustainable and more inclusive growth".*** The National Development Council (NDC) was supposed to give its final nod to the plan in its meeting scheduled on October 22, 2011 but as many working groups have not submitted their final reports to their respective divisions the process is getting delayed, it is expected to come to the NDC meeting by late 2012. As far as progress of the 12th Plan documentation is concerned, the NDC had approved the 'Approach Paper' on August 20, 2011 itself. The documents for 10th and 11th Plans too were finalised much later after the beginning of the respective Plan periods.

The Draft Approach Paper lays down the major targets of the Plan, the key challenges in meeting them, and the broad approach that must be followed to achieve the stated objectives which are summed-up as follows:

(i) Growth rate of 9 per cent is targeted for the Plan. However, in view of the uncertainties in the global economy and the challenges in the domestic economy, the Approach Paper indicates that it could be achieved only if some **difficult decisions** are taken.

(ii) It emphasizes the need to intensify efforts to have 4 per cent average growth in **agriculture** sector during the Plan period; with foodgrains growing at about 2 per cent per year and non-food grains (notably, horticulture, livestock, dairying, poultry and fisheries) growing at 5 to 6 per cent.

(iii) The higher growth in agriculture would not only provide broad based income benefits to the rural population but also help restrain **inflationary pressure**, which could arise if high levels of growth are attempted without corresponding growth in domestic food production capabilities.

(iv) It proposes that the major **flagship programmes** which were instrumental for promoting inclusiveness in the Eleventh Plan should continue in the Twelfth Plan – there is a need to focus on issues of implementation and governance to improve their effectiveness.

(v) The Plan indicates that the **energy** needs of rapid growth will pose a major challenge since these requirements have to be met in an environment where domestic energy prices are constrained and world energy prices are high and likely to rise further.

(vi) For the GDP to grow at 9 per cent, commercial energy supplies will have to grow at a rate between 6.5 and 7 per cent per year. Since India's domestic energy supplies are limited, dependence upon imports will increase. Import dependence in the case of petroleum has always been high and is projected to be **80** per cent in the Twelfth Plan.

(vii) Even in the case of **coal**, import dependence is projected to increase as the growth of thermal generation will require coal supplies which cannot be fully met from domestic mines.

(viii) It suggests the need to take steps to reduce energy intensity of production processes, increase domestic energy supply as quickly as possible and ensure rational energy pricing that will help achieve both objectives viz. reduced energy intensity of production process and enhance domestic energy supply, even though it may seem difficult to attempt.

(ix) It draws attention to evolving a holistic **water** management policy aiming at more efficient conservation of water and also in water use efficiency particularly in the field of agriculture.

(x) It argues that a new legislation for **land acquisition** is necessary, which strikes an appropriate balance between the need for fair compensation to those whose land is acquired and whose livelihood is disrupted, and the need to ensure that land acquisition does not become an impossible impediment to meeting our needs for infrastructure development, industrial expansion and urbanisation.

(xi) It maintains that **health, education** and **skill development** will continue to be focus areas in the Twelfth Plan and that there is a need to ensure adequate resources to these sectors – ***'universal healthcare'*** proposed by it, emphatically. Simultaneously, it also points to the need to ensure maximum efficiency in terms of outcomes for the resources allocated to these sectors. The need to harness ***private investment*** in these sectors has also been emphasised by the approach.

(xii) It takes cognizance of the fact that achieving 9 percent growth will require large **investments** in infrastructure sector development – notes greater momentum to public investment and Public Private Partnerships (PPPs) in infrastructure sector needs to be imparted so that present infrastructure shortages can be addressed early.

(xiii) It has emphasised the importance of the process of **fiscal correction**. However, the paper cautions that fiscal consolidation would imply that total resources available for the Plan in the short run will be limited. Resource limitations imply the need to prioritise carefully and that some ***priority areas***, e.g., health, education and infrastructure will have to be funded more than others.

(xiv) It also emphasizes the need for focusing more on **efficient use** of available resources in view of the resource constraints. The Paper makes several suggestions in this regard, including giving implementing agencies greater amount of freedom, flexibility, promoting convergence between resources from different Plan schemes and the need for much greater attention to capacity building, monitoring and accountability.

B. Twenty-Point Programme

The Twenty Point Programme (TPP) is the second Central Plan which was launched in July 1975. The programme was conceived for coordinated and intensive monitoring of a number of schemes implemented by the Central and the State Governments. The basic ***objective*** was of improving the quality of life of the people, especially of those living below the poverty line. Under this, a thrust was given to schemes relating to poverty alleviation, employment generation in rural areas, housing, education, family welfare and health, protection of environment and many other schemes having a bearing on the quality of life in the rural areas.

The programme was restructured in 1982 and 1986. The programme, known as the ***'TPP-86'*** has 119 items grouped into 20 Points which are related to the improvement in the quality of life in the rural areas. Among the total items, 54 are monitored on the basis of evaluatory criteria, 65 against pre-set physical targets and rest of the 20 important items on the monthly basis. The targets are fixed by the Ministries at the Centre in consultation with the states and the UTs. The allocation for the programme is done under the various Five-Year Plans.

The 'TPP-86' has been restructured and named 'TPP-2006' keeping in view the challenges of the 21st Century with particular reference to the process of the Economic Reforms. This is in harmony with the National Common Minimum Programme (NCMP) of the UPA Government.

Basically, the programme was targetted to the cause of poverty alleviation with the 'direct attack' approach. This experiment encouraged the Government to go for a whole Five-Year Plan with the slogan 'Garibi Hatao' (i.e the Sixth Plan, 1980–85). Over the years, the political changes at the Centre did not affect the programme and it has been continuously implented, more so due to its being of a high populist nature and known to the masses, as the experts believe.

C. MPLADS

The Member of Parliament Local Area Development Scheme (MPLADS) is the last of the Central Plans and latest to have been launched, too. The scheme was launched on December 23, 1993 with only Rs. 5 lakh given to each MPs which was increased to Rs. 1 crore in the year 1994–95. When the MPs did put a demand to increase the sum to Rs. 5 crore in 1997–98, finally the Government enhanced it to Rs. 2 crore since 1998–99. In April 2011 the corpus was enhanced to Rs. 5 crore while announcing the new guidelines for the scheme.

Basically, in the early 1990s there came a demand from the MPs cutting across the party line for such a scheme so that the fruits of development could directly reach the masses via their representatives. The Government of the time decided to go in for such a scheme and the MPLADS came.

Under this scheme the Members of Parliament[86] recommend some works (i.e. creation of fixed community assets, based on locally felt developmental needs) to the concerned District Magistrate. The scheme is governed by a set of guidelines, which have been comprehensively revised and issued in November 2005. Its performance has improved due to pro-active policy initiatives, focus monitoring and review.[87]

In recent years, many criticisms of the scheme came to the public notice which concerned either misappropriation of the funds or non-use of the funds, especially from the backward states. The people's representative at the PRI level have been demanding scrapping of the scheme as it infringes the idea of decentralised planning. In it's place, they want the funds to be given to the local bodies directly for the same kind of works specified by the MPLADS.[88]

The MOSPI (Ministry of Statistics and Programme Implementation) issued ***revised guidelines*** for the Scheme in ***August, 2012*** with following salient features – .

i. Assistance to physically challenged persons upto maximum of Rs.10 lakh per year for purchase of *tri-cycles* and *artificial limbs* have been allowed,

ii. Ambulances/hearse vans under the District Authority/CMO/Civil Surgeon of the district can now also be operated through private organizations,

iii. MPs allowed to recommend eligible works upto Rs.10 lakh per year outside the constituency for Lok Sabha MPs and outside States for Rajya Sabha MPs.

iv. Advances to Government implementing agencies increased to the ratio of 75:25 (from 50:50).

v. Contingency Funds of 0.5% have been increased to 2% of the annual entitlement as administrative expenses.

vi. Works can also be implemented in areas affected by *man-made calamities* like chemical, biological and radiological hazards.

vii. Mobile Library for Government Educational Institutions/Public Libraries now permissible.

viii. Works from out of the shelf of MGNREG. A project approved by the Zilla Panchayat for the year may also be recommended under the MPLAD Scheme. Similarly, ***convergence*** of MPLADS funds with Panchayat Yuva Krida aur Khel Abhiyan (PYKKA) and Urban Sports Infrastructure Scheme (USIS) for creation of durable sports assets from out of the shelf of PYKKA Projects has been allowed.

ix. Funds can be used now for construction of Railway Halt Stations to facilitate the local community for boarding/deboarding the train.

x. An MP has been entitled for setting up of MPLADS Facilitation Centre in the Nodal District for which MPLADS funds not exceeding Rs. 5 lakh being the cost of equipments, furniture, etc. can be used. The space/room would be provided by DC/DM in the premises of Collectorate/DRDA and the recurring running expenses will be booked under 2 per cent of the administrative charges, of which the Nodal District gets 0.8 per cent.

xi. MPs may recommend purchase of ***books*** up to Rs. 22 lakh annually for

schools/colleges/public.

Besides, an annual competition ***'One MP – One Idea'*** was also introduced for selecting three best innovations in solving local problems to be held in each Lok Sabha Constituency.

MULTI-LEVEL PLANNING

It was by the late 1950s and the early 1960s that the states demanded the right to plan at the state level. By the mid-1960s, the states were given the power to plan by the Centre advising them that they should promote planning at the lower levels of the administrative set strata, too i.e. the district level planning–via the Municipalities and Corporations in the urban areas and via Block level through Panchayats and the Tribal Boards. By the early 1980s, India was a country of the multi-level planning (MLP) with the structure and strata of planning as follows:

First Strata: The Centre Level Planning

At this level three types of Central Plans had evolved over the years—the Five Year Plans, the Twenty Point Programme and the MPLADS.

Second Strata: The State Level Planning

By 1960s, the states were planning at the state level with their respective planning bodies, the state Planning Boards with the respective CMs being their de-facto Chairman. The States Plans were for a term of five years and parallel to the concerned Five–Year Plans of the Centre.

Third Strata: The District Level Planning

By the late 1960s all the districts of the states were having their own plans with their respective District Planning Boards[89] with the respective District Magistrates being their de-facto chairmen. The district level plans are implemented now via Municipalities or Corporations in the urban areas and the Panchayats via the Blocks in the rural areas.

Fourth Strata: The Block Level Planning

As a part of the district level planning the Block level Planning came up which had the District Planning Boards as their nodal body of planning. Below the Blocks, India developed the planning at the local level, too.

Fifth Strata: The Local Level Planning

By the early 1980s, plans were being implemented at the Local Level via the Blocks and had the District Planning Boards (DPBs) as the nodal agency. Due to socio-economic differentiations among the population, Local Level Planning in India developed with its three variants,[90] namely–

(i) Village Level Planning

(ii) Hill Area Planning

(iii) Tribal Area Planning

Basically, the MLP was started to promote the process of decentralised planning in the country. It was the Indian version of democratic planning which ultimately sought to guarantee the people's participation in the process of planning. But it failed to do so due to many reasons. The reasons have been discussed below:

(i) It could not promote people's participation in the formation of the various plans. The basic idea of the MLP model was that once the local level plans will be handed over to the blocks, the blocks will make their plans and once the blocks hand over their plans to the districts, the district level plans will be formulated. Similarly, the state plans and finally the Five-Year Plan if the Centre will formulate one. By doing so, every idea of planning will have the representation of everybody in the country at the time of plan formation—a special kind of plan empathy would have developed out of this process. But this was not the reality. Every strata made their own plans—lacking the empathy factor.

(ii) Only Central Plans were implemented as the states lacked the required level of the finance to support their plans. They ultimately had to be satisfied by implementing the Central Plans which failed to include the states' empathy.

(iii) As the Local Bodies in India were not having any constitutional mandate, they just played the complementary roles to the state Planning process. As they had no financial independence, their plans, even if they were formulated, remained on paper only.

(iv) The MLP, thus, failed to include the people's participation in planning, badly betraying the local aspirations.[91]

But at least the failure of the MLP made the Government to think in the direction of decentralised planning afresh leading to the enactment of the two important Constitutional Amendments–the 73rd and the 74th.

WAY TO DECENTRALISED PLANNING

Economic planning was basically an element of the centralised kind of political system (i.e. the socialist and the communist). When India decided in favour of planned economy it was to face double challenge:

(i) First challenge was to realise the objectives of planning in a time-bound frame and

(ii) Making economic planning a suitable instrument of development in the democratic set up was the other challenge—to democratise and decentralise the process of planning itself.

The Government tried to decentralise the planning process by setting up the NDC and promoting the MLP but without being able to achieve the desired results. By the late 1980s, a direct link was established[92] between development and democracy. And it was established that the above-given challenges were basically complementary—without solving the second challenge (i.e. decentralisation) the first challenge (i.e. development) cannot be solved. Finally, once the PRIs were given the constitutional status first time planning became a constitutional excercise at any level i.e. at

the panchayat level.

Though the planning at the central and the state levels are still extra-constitutional activities, it has become constitutional at the local bodies level. Kerala has shown some pathbreaking good works via local body planning.[93] But still there are many hurdles to be solved before the local bodies are really able to plan for their proper development. These hurdles as per the experts are as under:

(i) The financial status of the PRIs is still not stabilised.

(ii) Which taxes the PRIs can impose are still not clear

(iii) The state Assemblies have been procrastinating in delegating timely and needful powers to the PRIs.

(iv) Low level of awareness among the local people regarding their Right to Information and the right functioning of the PRIs

(v) Use of money and muscle power in the PRI elections in some states

By mid-2002, there took place an all India Panchayat Adhyaksha Sammelan in New Delhi. At the end off the meet, the Panchayat Adhyakshs handed over '21 Point Memorandum' to the Government which specially dealt with the financial status of the PRIs. In July 2002, while the then PM was addressing the annual meet of the District Rural Development Agency (DRDA), he announced that the PRIs will be given 'financial autonomy' very soon. He further added that once there is a political consensus, the Government might go in for a further constitutional Amendment. Unfortunately, the same coalition (i.e. the NDA) did not come to power in the forthcoming General Elections. But the UPA Government does not look less serious on the issue of participatory development. By mid-2006, the Planning Commission wrote letters to every Chief Minister of each state that before the Eleventh Plan commences it wants that all the PRIs are duly delegated their functional powers of planning from the concerned states. Otherwise, the funds kept for local development would not flow to the states. This shows the seriousness of the Central Government.

Once there is a right level of awareness among the local people and the PRIs are able to take their real shape, the planning process will get decentralised, we may be sure of that.

THE PLANNING COMMISSION & THE FINANCE COMMISSION

Federal political systems provide independent financial control to the central as well as the state Governments so that they are able to perform their exclusive functions.[94] For the same objective, the Constitution of India has made elaborate provisions[95] i.e. setting up of a Finance Commission to recommend to the President certain measures relating to the distribution of financial resources between the Union and the States. But the powers given to the Finance Commission by the Parliament limited its functions to the extent of finding out revenue gap of the states besides recommending for the 'grant-in-aids, to the states from the centre. The finance commission cannot determine the capital-related issues of the states (though the constitution does not classify between the capital or revenue related roles of the commission while determining the centre's assistance to the states).

In the meantime, to promote the process of planning, an extra-constitutional body i.e. the Planning

Commission was set up even before the First Finance Commission was set up. The Planning Commission plays a very vital role in the process of determining central assistance to the states as all development plans, programmes and projects are within its purview. All grants or loans given by the centre to the states for developmental works are practically dependent on the recommendations of the Planning Commission. And that is why the role of the Planning Commission was said to 'confine'[96] the role of the Finance Commission i.e. a non-constitutional body eclipsing a constitutional body. P.J. Rajamannar who headed the Finance Commission (1966–69) suggested to clearly define the relative scope and functions of the two commissions by amending the Constitution, and the Planning Commission was advised to be made a statutory body independent of the Government. But no such follow ups came from the successive Governments at the Centre. But one thing was important, most of the Finance Commissions devoluted some extra shares in the central taxes (i.e. the income tax and the central excise) and grants-in-aid.

Since the decade of 1990s, certain events made the Central Government change its mindset regarding the role of the states in the process of development. Major events may be counted as under:

(i) The process of economic reforms started in 1991–92 required active economic participation from the states.

(ii) The constitutional requirement of 'participatory planning' mandated by the 73rd and the 74th Constitutional Amendments was enacted in 1993.

(iii) The arrival of coalition era at the centre when over dozen political parties, having regional affiliations came together to form the Government.

(iv) The recommendations of the Tenth Finance Commission followed by a constitutional Amendment making Alternative Method of Devolution a law in 1995.

(v) Various new needs of the time such as tax reforms, agricultural development, industrial expansion, etc.

The year 2002 could be considered as a watershed in the area of promoting the states' need of financial resources in promoting their developmental requirements. In July 2002, while the Government was setting up the Twelfth Finance Commission (2005–10) the then Minister of Finance announced that in future the Planning Commission will be *playing more or less a role of collaborator to the Finance Commission*. In the same announcement, the Government made one member of the Planning Commission, a member of the Finance Commission too (a symbol of physical and ideological connection between the two bodies).[97] It was as if the Government had accepted the suggestions of the Fourth Finance Commission to a great extent. Though the critics took it as an infringement of a constitutional body by a non-constitutional one, the Government clarified by calling it a symbol for promoting the contemporary needs of the economy and the fiscal federalism.

Another milestone was created in the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 which empowers the state Governments to go for market borrowings to fulfill their plan expenditure without prior permission from the central Government (provided they have enacted their respective Fiscal Responsibility Acts).[98] This has boosted the participatory planning in the country by guaranteeing greater autonomous plan participation from the states.

If we look at the tax reforms process, we see a general tendency of enabling the states to collect more and more taxes, the Value Added Tax (VAT) being a glaring example by which almost all states have

been able to increase their gross tax revenue receipts. The cause will be served more once the economy goes for the proposed enactment of the Goods and Services Tax (GST) from the fiscal 2009–10.

Thus, we see an overall change in the mindset of the Central Government towards allocating more financial resources in favour of the states which has been also shown by the Tenth and Eleventh Plans.

THE CHANGING NATURE AND ROLE OF PLANNING

Led by various inter-connected and experience-based factors, a great many ***new elements*** have been included in the Indian planning process in recent years. Some of the new elements are too path breaking to reverse the very established thinking of planning in the country. Still some of them could be seen as the Government's attempt to address some of the long-standing and overdue criticisms of planning in India. The inclusion of the new ***methods*** and ***strategies*** of planning has gone to change the very ***nature***, ***role***, and the ***scope*** of planning in the country. It was the Tenth Plan which is credited of doing this. Many 'first time' initiatives were taken up by the Plan. Usually, the plan projections in India did talk about development in the recognised sectors, but here the Tenth Plan imaginatively forges ahead towards new goals—it was undoubtedly a historic moment. The new measures initiated by the Plan[99] which led to changes in planning may be seen as under:

1. The Role of State in Planned Development

It was for the first time that the Planning Commission not only went for a detailed talk on the states' concerns but also emphasised and recognised their role in the process of development planning (in Vol. III, Tenth Plan). The Plan accepts that unless the states achieve their targets, a nation cannot achieve its targets. This is an open acceptance of the state's role in the planning and clear pointer to the need for decentralised planning. The full meet of the Planning Commission which passed the Tenth Plan advised two important ideas in this regard:

(i) to make the Tenth Plan a ***'People's Plan',*** and

(ii) to make development a ***'People's Movement.'***

The Deputy Chairman, Planning Commission articulated on the ocassion that 'people's say in Plan is a must'. The Chairman, Planning Commission emphasised that only economic growth should not be our objective but improvement in the quality of life of the masses should be the real goal of planned development. He further added that people's participation in the planning process is a must to make development a mass movement and helpful to all. This idea continued in the 11th Plan and proposes the 12th Plan (2012-17).

2. Agriculture Sector Accepted as the Driving Force of the Economy

There had been a bias against the agriculture sector around the world after the Second World War–

emphasising agrarian economy was considered a symbol of backwardness. This mindset, ultimately, changed the early 1990s to which the World Bank also agreed. Though the Union Budgets of 2000–01 and 2001–02 clearly referred the proposition, it was the Tenth plan which clearly accepted the ‘agriculture sector’ as the Prime Moving Force (PMF) of the economy. The Nobel Laureate Amartya Sen has also suggested on the same lines.[100]

The Plan further adds that by prioritising agriculture (in place of industry) the economy will be able to solve three major problems which have been ailing the economy:

(i) With the increase in the agricultural production the economy will have food security,

(ii) Emphasis on agriculture will give a great thrust to employment generation (92 per cent of the employment is today generated by the unorganised sector with agriculture being the biggest), and

(iii) Purchasing power of the masses will increase which will reverse the long-standing situation of the ‘market failure’ in the economy (that is why India sells lesser industrial goods and the industries lack the market for their products. It means by emphasising upon the agriculture sector, the economy will be able to boost its income from the industries).

Accepting agriculture as the ‘core element’ of the economy, the Plan suggested key reforms which are at their various stages of implementations:

- Elimination of inter-state barriers of trade and commerce;
- Encouraging contract farming and permitting leasing in and leasing out of agriculture lands;
- Need to amend the Essential Commodities Act;
- Liberalising agri-industry, agri-trade and exports;
- Replacement of various acts concerning food by one comprehensive ‘Food Act’;
- Permitting ‘future trading’ in all commodities;
- Removal of restrictions on financing of stocking and trading.

3. Governance Recognised among the Most Important Factors of Development

It was for the first time that the economic think tank, the Planning Commission went to comment upon the issue of Governance (which has been only of political concern till date and the PC never thought to ponder upon such issues). In its first comment upon it the PC recognised governance among the most important factors to realise the planned goals (a full chapter devoted to it in Vol. I, Tenth Plan). The Government also did set up an empowered committee on the matter which advised a list of reforms:

- Improved people’s participation through the PRIs;
- Increased involvement of Civil Society and the NGOs;
- Civil Service reforms for improving transparency, accountability and efficiency; security of tenure for the civil servants with more equitable system of rewards and punishments;
- Rightsizing both the size and role of Government;
- Revenue and judicial reforms and
- Use of Information Technology for ‘good governance’

After the World Bank report on 'Good Governance' in the mid-1990s, the Government has been trying to sensitise the issue. Finally, it was the Tenth Plan which accepted the immediate need for good governance.

4. New Steps of Economic Reforms to be Taken by the State

In a major decision it was articulated that now onwards all the new steps of economic reforms will be taken by the states with the centre playing a supportive role. It was the time when the Government initiated the Second Generation of the Economic Reforms. Till date the states had been playing a secondary role in the process of economic reforms. That is why the economy had not been able to tap the expected benefits from it. Now the method and strategy from the reforms process have gone in for a change.

5. Monitorable Targets of Development Set for the First Time

There used to be planned targets in the past but this time an innovative way of setting these targets was initiated. The Plan did set, for the first time, a national level monitorable targets in eleven areas, showing development:

(i) Poverty reduction: 26 to 21 per cent by 2007 and to 15 per cent by 2012.

(ii) Population growth rate: 21.3 to 16.2 per cent by 2001–11.

(iii) Growth in gainful employment to, at least, keep pace with addition to the labour force over the Tenth Plan period.

(iv) Schooling: 100 per cent enrollment by 2003 and five years compulsory schooling by 2007 to be completed by 2012.

(v) Literacy: 65 to 75 per cent by 2007 and further increased to 80 per cent by 2012.

(vi) Infant Mortality Rate: to be reduced from 72 to 45 by 2007 and 28 by 2012 (per 1000).

(vii) Maternal Mortality Rate: to be reduced from 40 to 20 by 2007 and 10 by 2012 (per 1000).

(viii) Potable water: to all villages by 2012.

(ix) Reducing Gender gaps: in Literacy and wage rates by 50 per cent by 2007.

(x) Forest Cover: to be increased to 19 per cent by 1999–2000, 25 per cent by 2007 and 33 per cent by 2012.

(xi) De-polluting the waterbodies: major rivers by 2007 and other notified water stretches by 2012.

The monitorable targets have importance as the concerned central Ministries are parties to its realisation. The ministries hand over an undertaking to the PC about their strategies of realising the targets and performance reports are submitted by them which become bases for the monitoring by the PC.

MONITORABLE TARGETS SET BY THE 12TH PLAN

To focus the energies of the government and other stakeholders in development, it is desirable to identify monitorable indicators, which can be used to track the progress of our efforts. Given the complexity of the country and the development process, there are a very large number of targets that can and should be used – however, there is a **core set of indicators** which could form the objectives towards which all development partners can work, which includes not only the Central and State Governments, but also local governments, CSOs (Civil Society Organisations) and international agencies.
The **12th Plan (2012-17)** has set *Twenty-five Monitorable Targets* in *seven broad areas* reflecting its (India's) '*vision of rapid, sustainable* and more *inclusive growth':* *

Economic Growth

1. Real GDP Growth Rate of 8 per cent.
2. Agriculture Growth Rate of 4.0 per cent.
3. Manufacturing Growth Rate of 10.0 per cent.
4. Every State must have an average growth rate in the Twelfth Plan preferably higher than that achieved in the Eleventh Plan.

Poverty and Employment

5. Head-count ratio of consumption poverty to be reduced by 10 percentage points over the preceding estimates by the end of Twelfth Five Year Plan.
6. Generate 50 million new work opportunities in the non-farm sector and provide skill certification to equivalent numbers during the Twelfth Five Year Plan.

Education

7. Mean Years of Schooling to increase to seven years by the end of Twelfth Five Year Plan.
8. Enhance access to higher education by creating two million additional seats for each age cohort aligned to the skill needs of the economy.
9. Eliminate gender and social gap in school enrolment (that is, between girls and boys, and betweenSCs, STs, Muslims and the rest of the population) by the end of Twelfth Five Year Plan.

Health

10. Reduce IMR to 25 and MMR to 1 per 1,000 live births, and improve Child Sex Ratio (0–6 years) to 950 by the end of the Twelfth Five Year Plan.
11. Reduce Total Fertility Rate to 2.1 by the end of Twelfth Five Year Plan.
12. Reduce under-nutrition among children aged 0–3 years to half of the NFHS-3 levels by the end of Twelfth Five Year Plan.

Infrastructure, Including Rural Infrastructure

13. Increase investment in infrastructure as a percentage of GDP to 9 per cent by the end of Twelfth Five Year Plan.
14. Increase the Gross Irrigated Area from 90 million hectare to 103 million hectare by the end of Twelfth Five Year Plan.
15. Provide electricity to all villages and reduce AT&C losses to 20 per cent by the end of Twelfth Five Year Plan.
16. Connect all villages with all-weather roads by the end of Twelfth Five Year Plan.
17. Upgrade national and state highways to the minimum two-lane standard by the end of Twelfth Five Year Plan.
18. Complete Eastern and Western Dedicated Freight Corridors by the end of Twelfth Five Year Plan.
19. Increase rural tele-density to 70 per cent by the end of Twelfth Five Year Plan.
20. Ensure 50 per cent of rural population has access to 40 lpcd piped drinking water supply, and 50 per cent gram panchayats achieve Nirmal Gram Status by the end of Twelfth Five Year Plan.

Environment and Sustainability

21. Increase green cover (as measured by satellite imagery) by 1 million hectare every year during the Twelfth Five Year Plan.
22. Add 30,000 MW of renewable energy capacity in the Twelfth Plan.
23. Reduce emission intensity of GDP in line with the target of 20 per cent to 25 per cent reduction over 2005 levels by 2020.

Service Delivery

24. Provide access to banking services to 90 per cent Indian households by the end of Twelfth Five Year Plan.
25. Major subsidies and welfare related beneficiary payments to be shifted to a direct cash transfer by the end of the Twelfth Plan, using the Aadhar platform with linked bank accounts.

States are encouraged to set ***state-specific targets*** corresponding to the above, taking account of what is the reasonable degree of progress given the initial position. Sector-wise monitorable growth targets set by the States have also been given by the Plan.

6. Differential Development Strategy Adopted

The Tenth Plan accepts that national targets do not necessarily translate into balanced regional development. It further adds that the potential and constraints of each state differ vastly. That is why the Plan goes on to adopt a differential development strategy. Under this strategy, separate state-wise growth and other monitorable targets were worked out by the P.C. for the states with their consultation so that the states can focus on their development plans. The states are getting central plan support according to their development requirement now as against the past pattern of plan

allocations. The developmental funds to the states and the central loans to them now accrue subject to their performance concerning the monitorable targets set for the states (to which they agreed).

7. Monitoring the Progress of Various Central Ministries

With the Tenth Plan the Government has started a process under which the progress of different Central Ministries is monitored by the PC. This is how the policy initiatives of the various Ministries and the PC's idea of development have been streamlined. The PC has really emerged as a 'super cabinet' in this way.

8. Relevance of Planning to Economic Reforms

After the two Five Year Plans (the eighth and the ninth) were already implemented, the Government took up the cause of establishing a relevance between the process of planning and the broader process of economic reforms. Different steering Committees have been set up which look after the plan implementation of the different sectors according to the decided idea of the economic reforms. This step should be seen as the Government's answer to the critics who opined that planning has become irrelevant in the era of economic reforms.

9. Reforming the Planning Process

The Government called this Plan a 'reform plan' rather than a 'resource plan'. There has been a long-standing criticism about Indian plans that they are mere excercises in the resource mobilisation. Probably, the PC has tried to do away with this criticism. The above given seven points visibly prove that the Tenth Plan was not merely a 'resource plan'. Basically, the Plan initiates many pathbreaking changes in the planning process–its methods, strategies and the ideas–all at the same time. Rightly, it has been called a 'reform plan' by the PC. Second, this was the first plan in the era of economic reforms which accepts to go for establishing relevance to the process of the economic reforms. From this perspective, too, this Plan is a 'reform plan'.

The inclusion of the above-given new elements into the Indian planning process has gone to really change the nature, role and scope of planning in the country. All these new elements are today carried forward by the Eleventh Plan with an emphasis wherever it is required. The planning process is more grown up today in India as the changes in the political arrangements at the centre do not seem to be affecting it unlike the past.

A CRITICAL EVALUATION

Planning has been subject to a number of criticisms right since its inception in the country. With the passage of time, not only the number of criticism increased but more importantly the shortcomings of planning were pointed out. Although after considerable delay, but the Governments took note of the shortcomings besides taking some major steps. The criticisms stand even today but with one difference that the Government is not only conscious of them but also trying to do away with them. We may briefly discuss the major criticisms of planning in India as well as the follow ups from the

Government to do away with them as under:

1. Lack of 'Perspective' in Planning

According to experts, if a nation is going for economic planning it must have 'perspective' element in it. To have perspective in planning, two basic elements need to be fulfilled, namely—

(i) Planning should be evaluation-based, and

(ii) 'long-term' goals should be followed up besides the 'short-term' goals.

In the Indian content, the succeeding plans have been always commenced without the full evaluation of the preceding Plan. This was mainly due to following reasons:

(a) Lack of a nodal body responsible for data collection at the national level;

(b) Federal nature of polity made data collection full of delays and also due to higher dependence on the states; and

(c) Speedier data delivery was not possible.

After the recommendations of the National Statistical Commission (Chaired by C. Rangarajan), 2000, the Government discussed to set up a nodal body for data collection at the pan-India level, cutting across federal hurdles. Computerisation is already being done for speedier data delivery. For the time being the Plans are launched on the basis of projected data (provisional, latest, etc.) which is almost near the real data. But once the above discussed arrangements are in place, Indian planning will be based on evaluation, undoubtedly. In the meantime, the 'Quarterly Review' and the 'Performance Budgeting' of the Union Budgets have brought in the evaluation element to a greater degree./

The First Plan had set long-term goals (for the coming 20 years) besides the short-term goals (for five years). But over the time, falling confidence in mobilising required resources and political uncertainties at the centre made it a convention to set only short-term targets of planning. This shortcoming seems to be done away with after the commencement of the Tenth Plan. The Plan did not go for setting long-term goals only but even did set monitorable targets for the Eleventh Plan, too.

Point should be noted here that the Government had been conscious about the need for perspective planning as a separate Division with the same name, which has been functioning in the Yojana Bhavan since the mid-1970s (***Planning Commission has 25 Divisions today***).

2. Failure in Promoting a Balanced Growth and Development

Indian planning is blamed for failing the objective of a regionally balanced growth and development. Though the Second Plan itself had noticed this fact, the measures taken were not sufficient or were short-sighted. Economic planning at the national level has proved to be a highly effective tool of promoting balanced growth. But in the Indian case it turned out to be the opposite.

To take care of the issue of balanced growth, the planning process has been using the right tools, i.e. allocating plan funds on a sectoral (primary, secondary and federal reasons) basis. But due to political reasons, enough discrepancies cropped up in the method of allocating funds to the states. At the theoretical level, the Governments knew the remedies but at practical levels politics dominated the planning process. Democratic immaturity and politicisation of the planning process is to be

blamed for this.

Now things have changed for the better. The Government is following a two-pronged strategy to achieve the objective of a balanced growth and development in the country:

(i) Backward regions today are prioritised in directing the Central Government investment (very much same since the 1950s) but a new beginning in the 'differential development strategy' has been made by the centre with the Tenth Plan. Under this strategy, the development constraints of the different states are to be tackled with a differentiation in the strategy. The more needy states get more funds and assistance from the centre for their planned development, cutting across the political party lines (it is seen today as a symbol of political maturity on the issues of economic development, at least).

(ii) There is also a complementary strategy of the planning to address the matter of regional imbalance in the country. After the country started the process of economic reforms, the nature of planning was to incline more and more towards indicative planning. The economy was to be more and more dependent on private sector investment for its future development. And the private sector will be, naturally, more interested in investing in the regions which have better infrastructure support. Since the developed regions have better infrastructure they will attract the highest level of private investment which will again accelerate the process of imbalanced growth. To tackle this problem, the centre is promoting the states with lower infrastructure so that they can overcome the disadvantage. The process is slower but at least the Government is addressing the issue which is not less satisfying and there is no criticism to this strategy. Still balanced growth and development is going to be a great challenge for planning in India.

3. Highly Centralised Nature of Planning

Decentralising the process of planning has been a major goal of the Governments since the 1950s itself. But after Nehru, with every Plan we see greater tendency of centralisation in the planning process. Setting up of the NDC and the promoting the multilevel planning (MLP) did not serve much purpose in the direction. It has been among the criticised areas of the planning in India as the National Planning Committee as well as the First Plan itself had called for 'democratic planning' in the country.

By the mid-1980s, the mindset of the centre went for a change and the need for decentralised planning got proper attention. Finally, by early 1990s two constitutional Amendments (i.e the 73rd and the 74th) promoted the cause of decentralised planning by delegating constitutional powers to the local bodies. With this, a new era of planning began but still the planning of the local bodies is in the nascent stage due to lack of proper financial provisions for them. Once the financial provisions for them are evolved to the adequate level or the local bodies are given financial autonomy, the process of decentralised planning will surely get a new direction and meaning, as the experts believe.

In the meantime, the Tenth Plan emphasised upon a greater role for the states in the planning process. The Plan started a concerted effort to include the states' participation in the national planning process. The Centre is today more concerned about the development constraints of the states and is trying to adequately support the State Plans to the extent it is possible. In return, the centre wants greater and transparent fiscal compliance from the states. This approach continued during the 11th Plan and so has been committed for the 12th Plan, too. After some time we may hope that this

criticism of Indian planning will lose it's ground.

It is high time now that the planning process of the nation tries including the mass participation. The ***Economic Survey 2011-12*** rightly devotes a section to dwell into contracts and how the **civil society** and citizens play a key role in fostering economic growth. *"Honesty, punctuality, the propensity to keep promises, the attitude towards corruption are matters shaped in great part by norms and social beliefs and the behaviour patterns can become habitual. Moreover, in a democracy like India, what can be done by government depends in great measure on how ordinary people think and what people believe in,"* it says. The Survey further adds that the **civil society** has been campaigning to put in place new institutions, such as the Lokpal Act, to ensure the quality of service and bring about transparency through steps such as auction of natural resources while the government has either been slow or resisted several changes[101] .

4. Lop-sided Employment Strategy

Planning in India has been tilted heavily in favour of 'capital intensive' industries, especially from the second Plan onwards. Such industries in the public sector could not generate enough employment. In place of it India should have gone in for the 'labour-intensive' industries. In the era of economic reforms, the attitude changed and the planning process is promoting the agriculture sector with an emphasis on agri-industries and agro-exports to create more gainful and quality employment opportunities. The earlier emphasis on 'wage-employment' has shifted towards 'self-employment' to do away with the lop-sided employment strategy of the past.

5. Excessive Emphasis on the PSUs

Indian planning emphasised on the public sector undertakings (PSUs) for the right reasons but in the wrong way and for a considerably long period. And, for a considerably longer period of time the loss-making PSUs were carried on. The state's monopolies in certain areas continued over such a long period that too in losses that there came a demand-supply gap in the major goods and services produced by the PSUs. Though very conducive policy changes were effected after the country started reform processes, the hangover of the past is still looming large. Several reforms in the PSUs as well as a more liberal approach towards the private sector with market reforms are needed to phase out the discrepancies created by the over emphasis on the PSUs.

6. Agriculture Overshadowed by the Industry

Promoting the cause of faster industrialisation over time became so dear to the planning process that the agriculture sector got badly over-shadowed. Though the Plans were highlighting or prioritising agriculture, the industrial sector and the PSUs were glorified in such a way that time and resources both were scarce for the agriculture sector. Such a policy always created a situation of food insecurity (even today) for the country and the masses who depended upon agriculture for their livelihood and income (still it is 58.2 per cent)[102] could never increase their purchasing power to a level that the economy could reverse the situation of 'market failure'. In India, even today, industrial growth is badly dependent on agricultural growth.

The Tenth Plan recognises agriculture as the 'core element' of development. This is a welcome ideological change in the strategy of planning. Now the industries can sustain themselves but the laggard agriculture sector needs some special care and promotion from the Government, so that the masses who earn their livelihood from agriculture can benefit out of the WTO-promoted globalisation. The agriculture sector is in emergent need of attention, otherwise, the process of globalisation is going to be ineffective in benefitting the masses.

7. Faulty Industrial Location Policy

There are time-tested theories of 'industrial location' considering the nearness of raw materials, market, cheaper labour, better transportation and communication, etc. But the Plans always prioritised setting up new industrial units (i.e. the PSUs) in the backward regions of the country which falsify the theories of industrial location. The Government needs to develop all industrial infrastructures besides setting up certain PSUs. As the PSUs require skilled labour force, the regions failed to gain any employment from the PSUs too. The Government still continues with the same policy of setting up industries, but now the new PSUs are hardly set up in traditional areas.

8. Wrong Financial Strategy

Mobilising resources to support the highly capital-intensive Plans (courtsey the PSUs) has always been a challenge for the Government. To support the Plans, no stones were left unturned namely, going for a highly complex and liberal tax structure, nationalising the banks, etc. Ultimately, tax evasion, the menace of parallel economy and lesser and lesser capital for the private sector were the bane of India. Expansion of subsidies, salaries and the interest burden every year gave an upward push to the non-plan expenditure leading to scarcity of funds to support the plan expenditure (i.e the developmental expenses).

In the era of reforms, the Governments started giving attention to the financial strategy of supporting the plans in the right way. Besides, tax reforms, the financial reforms, as well as fiscal consolidation have been given proper care in recent years.

9. Politicisation of the Planning Process

In a democratic political system, almost every issue of socio-political importance is influenced by politics. It is more correct in the case of lesser matured democracies. The same stands true for the process of planning in our country. Greater and greater politicisation of the planning process culminated in such a design that at times economic planning served the opposite purpose. For example, we know that planning is a tool for promoting regionally balanced growth but in India in the process of serving vested political interests of the Centre, it resulted into promoting an imbalanced growth.

In the recent years governments have tried to address the major criticism of planning in India. More such constructive steps with better results are expected in future. More aware and better informed citizens will lead to better and better planning in future.

There has been a general anger among the sections of society regarding the coalition politics, scams, etc. in recent years. The ***Economic Survey 2011-12*** rightly *blames coalition politics* and the *federal*

structure for tardy decision making in several areas - from oil subsidy to tax reforms, FDI in retail and free movement of foodgrains. Almost everyone outside the government blamed it for *policy paralysis*. The Survey notes it as an area of concern. The Survey notes that ***politicians*** and ***policymakers*** can set the ball rolling by acting as ***role models*** but it also cited the poor record on enforcement of contract to argue that people's attitude needs to change. *"In these everyday situations (such as hiring a cab or a painter) it is cumbersome to bring in the state and the law courts. Here the main guarantor has to be people's personal integrity and trustworthiness,"* it says. The statement comes from a government that has been battling a spate of *corruption scandals* - ranging from those in the telecom sector to Commonwealth Games and criticism over poor governance standards and inability to push through critical decisions[103] .

The ***Economic Survey 2012-13*** has suggested a new objective for the Planning Commission – the global economic and financial crisis which has persisted for the last five years has not only exposed the vulnerability of almost all the countries over the globe to external shocks, but also has lessons for the ***planning process*** – countries need to have inbuilt social safety nets for facing such eventualities, which affect the weak and vulnerable the most, and wipe out the fruits of growth for ears. India with its focus on inclusive development and timely interventions has, however, been able to weather the crisis better than many other countries.[104]

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26. George Mathew, ***Power to the People*** in M.K. Santhanam edited, ***50 Years of Indian Republic,*** Publications Division, GoI, N. Delhi, 2000, p. 32.
27. L.C. Jain, et al., ***Grass Without Roots,*** Sage Publications, N. Delhi, 1985.
28. A. H. Hanson, 1966, op. cit, p. 180.
29. ***Gazetteer of India, Vol.3,*** op.cit, p. 5.
30. ***Gazetteer of India, Vol.3,*** op.cit, p. 5.
31. ***Gazetter of India, Vol.3,*** op.cit, p. 5.
32. ***Gazetter of India, Vol.3,*** op.cit, pp. 7–10
33. ***Gazetteer of India, Vol.3,*** op.cit, pp. 7–10.
34. Deputy Chairman, Planning Commission, May 1999. It is interesting to note here that the composition of the polity in Centre was dominated by the BJP while the Deputy Chairman, Planning Commission was K.C. Pant (an old congress man) – continuity in the basic ideas and objectives of planning being maintained.
35. ***India,*** various years taken together, Publications Division, GoI, N. Delhi.
36. Duely discussed by the NPC as well as the Constituent Assembly.
37. ***National Planning Committee Report;*** Also Nehru in ***The Discovery of India.***
38. The Preamble was declared by the Supreme Court as an ***integral part of the Constitution*** and any amendments amounting to a change in its meaning and spirit amounted to the violation of the 'basic feature' of the Constitution (Keshvanand Barti, 1973 and S.R. Bommai, 1994 cases). This further magnified the objectives and role of Planning in India.
39. As the different Articles of the Directive Principles got interpreted being complementary parts of the Fundamental Rights, their enforcement became obligatory for the Governments in coming times-still broadening the objectives of planning in the country.
40. Distribution of Legislative Power, List-III, Entry 20.
41. Though formal planning commenced in the fiscal 1951–52, the planning has already commenced with the Industrial Policy Resolution, 1948. More so, the Prime Minister of India who headed the NPC had already taken firm decision that India would be a planned economy by August 1937 (Congress Working Committee, Wardha) itself. Thus, the economy takes its first wink in the planned era!
42. Alan W. Evans, ***Economics and Planning,*** in Jean Forbes (ed.) ***Studies in Social Science and Planning,*** Scottish Academy Press, Edinburgh, 1972, p. 121.
43. ***Gazetteer of India, Vol.3,*** p.10, op. cit. The confusion regarding the time of setting up the PC needs to be settled. According to Bipon Chandra et al. (***India After Independence, p. 343, op. cit.***) the PC was set up in January 1950. Kalikinkar Datta (***An Advanced History of India, p. 956, op. cit.***) and S.R. Maheshwari (***Indian Administration, Orient Longman, N. Delh, 2002, p.121***) support the ***Gazetteer of India*** view. While A. Vaidya nathan (Dharma Kumar edited, ***The Cambridge Economic History of India, p. 949, op. cit.***) considers the PC to be set up in January 1950.
44. He was later given a Cabinet rank in the Union Council of Minister.
45. ***Gazetteer of India, Vol.3,*** p.11, op. cit.
46. ***India 2008,*** Publications Division, Ministry of Information and Broadcasting, GoI, N. Delhi, p. 676.
47. There was a provision of only *three* Cabinet Ministers as its ***ex-officio*** members namely the finance, Human Resource Development and Defence upto July 2004 when the United Progressive Alliance Government increased it to include the other *three* cabinet Ministers-the Railways, Agriculture and Information Technology. It has been only once in the history of the PC that it had *six* Cabinet Ministers as its ex-officio members i.e. in the final years of the Rajiv Gandhi regime (***The Economic Times, 16 July 2004, N. Delhi Edition***).
48. ***Gazetteer of India, Vol.3,*** p.11, op.cit.
49. Prima facie a body should be either constitutional or statutory to wield the executive powers but as a number of Cabinet Ministers as well as the PM himself are directly involved with the PC it wields execudive powers for all practical purposes.
50. ***Report of the Fourth Finance Commission*** (with P.J. Rajamannar as its Chairman), GoI, N. Delhi, 1965, pp. 88–90.

51. By 1950s it was a general criticism of the PC which looked highly logical. But through the entire period of planning the Governments never did think to convert the PC into a constitutional body. Practically enough, the Union cabinet and the whole Government is accountable to the Parliament for the functions of the PC as it has complete mandate and support of the Governments of the time.
52. Appleby, ***Public Administration in India: Report of A Survey***, Ford Foundation, 1953, p. 22.
53. As quoted in D.D. Basu, ***An Introduction to the Constitution of India,*** Wadhwa & Company, N. Delhi, 1999, p. 330.
54. ***Gazetteer of India, Vol.3,*** pp. 10–11, op.cit.
55. It is not uselessly that the Government decides to call in Montek Singh Ahluwalia, an economist of international repute to officiate as the Deputy chairman of the PC. Every idea and opinion of Mr. Ahluwalia is today understood by the coalition partners of the Central Government as a thing the Government is necessarily going to implement in future. One can imagine the increased role of the office and the PC, both, by this. There is always a hue and cry every time the Deputy Chairman articulates an idea or opinion. Though the PC is chaired by the PM, it seems that the Deputy Chairman has started availing enough autonomy to speak his mind.
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57. As per the original mandate the PC was supposed to formulate the state plans also. By 1960s, with the decision to follow the multi-level planning (MLP) in the country the states started having their own state planning boards (SPBs).
58. In setting these targets the concerned states were consulted approach of planning was followed.
59. ***Resolution No. 62/CF/50*** (06.08.1952), Cabinet Secretariat, GoI, N. Delhi.
60. ***First Five Year Plan: A Draft Outline,*** PC, GoI, N. Delhi, July 1951, p. 253.
61. ***Gazetteer of India, Vol.3,*** p. 10 op.cit.
62. The Advisory Planning Board (1946) set up by the Interim Government had suggested for such a consultative body with the representatives from the provinces, the princely states and some other interests to advise the Planning Commission for the success of planning in India.
63. Other than the ***Cabinet Resolution,*** it is also quoted is the ***Gazetteer of India, Vol. 3,*** p. 15, op.cit.
64. The ***italicised*** words are here highlighting the level of the Government's consciousness about the concerned issues of decentralised planning, regional and individual inequalities to which the planning was to be specially attentive.
65. George Mathew, undoubtedly among the legendary commentator on the Panchayat Raj/democratic decentralisation calls J.L. Nehru as "its most eminent champion at the national level" (***Power to the People*** in M.K. Santhanam edited ***50 Years of Indian Republic,*** Pub. Div., GoI, 2000, p. 31). Similarly, the reputed historians Bipan Chandra et al. call Nehru as "the greatest champion of planned economic development"– for Nehru the process of planning is the country was to be democratic about which seems very clear, as his writings support (***India After Independence,*** Bipan Chandra et.al., p. 341, op.cit.).
66. Sukhomoy Chakravarti, ***Development Planning: The Indian Experience,*** Oxford University Press, New York, 1989, pp. 9–11.
67. C. Rangarajan, ***Indian Economy: Essays on Money and Finance,*** **UBSPD, N. Delhi,** 1998, p. 272.
68. It should be noted here that as per the official version of the Government of India, the planning has been a *continuous process* in the country and there is no term like the 'Plan Holiday' in Its official documents. The term was given by the critics and popularised by the contemporary media.
69. Experts believe this Plan to be somewhat based on the ideas of D.P. Dhar, the Minister for Planning at that time.
70. As N.N. Vohra remarks.
71. It should be noted here that there is nothing like the 'Rolling Plan' in the official documents of planning in India. Basically, the origin of the concept of the 'Rolling Plan' goes back to the period when India went for the Annual Plans (1966–69) for the first time and the critics noted it as a ***discontinuity*** in the planning process calling it a period of the 'plan holiday'. The basic trait of the 'Rolling Plan' was its ***continuity*** while the congress commenced its Sixth Plan (1980–85) the idea of the 'Rolling Plan' was cancelled as for the new Government the element of 'rolling' (continuity) was already in the Indian Planning – India was following the approach of the 'perspective planning'. A separate Division of Perspective Planning was already functioning in the Yojana Bhavan since the mid-1970s. The two elements which make a plan a 'perspective plan' are – firstly, the 'continuity' and secondly, 'evaluation - based' planning. For the Congress Government, logically, the planning in India was not only 'rolling' but more than that – evaluation-based, too.

72. Some experts see this Plan as a symbol of the planning being converted to a complete politics – with utter populism entering into the planning process of India. The circle of the politicisation of planning gets completed with this Plan
73. 'Target group' approach of planning is selecting the group of people where a particular problem is and attacking the problem directly – the TPP was the first such programme in India.
74. ***India 1980–1983,*** Pub. Div., GoI, N. Delhi.
75. ***Seventh Five Year Plan*** (1980-85), PC, GoI, N. Delhi, 1980.
76. Similar financial strategy to promote growth and development had led the Soviet Union to economic collapse via the balance of payment crisis during Gorbachev's regime by 1991, as is pointed out by Jeffrey Sachs in ***The End of Poverty*** (Penguin Books, London, 2005, pp. 131–134).
77. C. Rangarajan, 1998, p. 274, op.cit.
78. ***Bimal Jalan*** in Bimal Jalan (ed.), 1992, pp. 190–191, op.cit.
79. This is official version for the delay (***India 2007,*** Pub. Div., GoI, 2007, p. 680).
80. It should be noted here that the kind of economic reforms India started in 1991–92 were ***almost ditto suggested*** by the Eighth Plan. The suggestions were based on India's own experience and the experiences of the world economies after the Second World War. The Sixth and the Seventh Plans had suggested almost on the similar lines which made the Governments of the time go for the so-called 'liberalisation' moves in the mid-1980s.
81. C. Rangarajan, 1998, pp. 275–276, op.cit.
82. ***India 2007,*** Pub. Div., pp. 682–83, op.cit.
83. ***Economic Surveys*** (1998–2002), Ministry of Finance, GoI, N. Delhi & ***India 2007,*** p. 683, op.cit.
84. ***Tenth Five Year Plan (2002–07),*** P.C, GoI, N. Delhi.
85. ***Mid-Term Appraisal of the Tenth Plan,*** P.C, GoI, N. Delhi.
86. For development works the MP, Lower House (the Lok Sabha) may select one or more districts of his/her constituency; the MP, Upper House (the Rajya Sabha) may select any one or more districts from his/her constituency (i.e. a state or an UT); and the Nominated MPs may select any one or more district from their constituency (i.e. the whole country).
87. As the Government reports in the ***India 2007,*** pp. 711–712, op.cit.
88. We may especially quote the '21 Point Memorandum' handed over by the ***All India Panchayat Adhyakshas Meet,*** mid-2002, N. Delhi to the President and the Central Government of the time.
89. After the implementation of the 74th Constitutional Amendments they have become the District Planning Committees (DPCs).
90. While people in some areas have socio-cultural similarities (as in the hill areas with no tribal population and the people living in the plains i.e villages) they lack economic similarities. Similarly, while people living in the tribal areas and the hill areas have economic similarities they lack socio-cultural similarities. That is why all these three habitations had three sets of planning patterns.
91. G.V.K. Rao Committee (CAARD), 1985; L.M. Singhvi Committee (CCPPRI), 1986 and Sarkaria Commission, 1988 all discussed this inter-connection (***Legislative Status of Panchayat Raj in India,*** IIPA, N. Delhi, 1997).
92. Governments' failure in including the local aspirations in the process of planned development has been considered by the major experts as the foremost reason behind the success of the regional political parties, which has led to the governments of the 'compromises' i.e. coalition Governments, at the Centre and in the states via the 'hung parliaments' and the 'hung assemblies', respectively.
93. Jose George, 'Panchayats and Participatory Planning in Kerala', ***The Indian Journal of Public Administration,*** Vol. XLIII, No.1, January–March, 1997.
94. As *K.C. Wheare* writes about the classical federal constitutions in ***Federal Government,*** Oxford University Press, 3rd Ed., 1956, p. 97.
95. Articles 270, 273, 275 and 280 of the ***Constitution of India.***
96. ***Report of the Fourth Finance Commission*** (chaired by P.J. Rajamannar), GoI, N. Delhi, 1965, p. 88.
97. It was ***Som Pal,*** who later resigned from the Planning Commission membership once the UPA Government came to power in mid-June, 2003.
98. This should be considered a great fiscal freedom to the states (which even the constitution could not forsee) and also making them behave with more responsibility in fiscal matters. More than 20 states have passed their Fiscal Responsibility Acts (FRAs) by now and are borrowing from the market for their planned needs.
99. ***Tenth Five-Year Plan,*** Planning Commission, GoI, N. Delhi, 2002.
100. While he was in India to receive the 'Bharat Ratna' award in 2001.

101. ***Economic Survey 2011-12,*** MoF, GoI, N. Delhi, p.30.
102. ***Economic Servey*** 2012-13, Mof, GoI, N.Delhi, p.173.
103. ***Economic Survey 2011-12,*** MoF, GoI, N. Delhi, p. 30.
104. ***Economic Servey 2012-13***, Mof, GoI, N.Delhi, p.269.

* ***Twelfth Five Year Plan (2012–2017)*** , 'Faster, More Inclusive and Sustainable Growth', Volume I, pp. 34-36, Planning Commission, GoI, N. Delhi, 2012

6

ECONOMIC REFORMS

*An important feature of India's reform programme, when compared with reforms underway in many other countries, is that it has emphasised gradualism and evolutionary transition rather than rapid restructuring or 'shock therapy'. This gradualism has often been the subject of unfavourable comment by the more impatient advocates of reform both inside and outside the country.**

** Montek S Ahluwalia addressing the inaugurating of the Seminar on 'India's Economic Reforms' at Merton College, Oxford University, London, June 1993.*

INTRODUCTION

The economic reforms initiated in 1991 is now into the 22nd year. In this period there was hardly a day that some news, news analysis, write up or article did not appear in the newspapers. Several highly acclaimed books have been authored on India's economic reforms by some of the best experts of economics from India and abroad. Still students, especially coming from non-economics background, are generally at a loss on the 'pros' and 'cons' of the reform process.

ECONOMIC REFORMS

Popularly, economic reforms denote the process in which a government prescribes declining role for state and expanding role for the private sector in an economy. So let's unravel the reform process based on the author's classroom interaction with students. It is safer to see economic reform as a policy shift in an economy from one to another or ***'alternative development strategies'.*** Economists attribute the differences in the performance of economies to the differences in the 'strategies' they follow. The different strategies of development evolved through a long period of trial and error by the different countries under the influence of different sets of ideologies. But the process has been like an educational trip. To understand the term 'economic reform' and more so to clarify the confusion concerning it in the Indian context, we must see the different 'alternative development strategies' which evolved through time. A brief description is given below:

1. Planning Model

Till the rise of the Soviet Union, the prevalent development strategy in the Euro-American countries was the capitalist system of economy which promoted the principles of the laissez-faire and dominant role for the private capital in the economy. Once the Soviet Union went for the planning model (including the East European countries and finally China in 1949) most of the developing countries after their independence were influenced by socialism and the governments there took a central role in planned development. As these economies were dominated by foreign colonisers, they worried that opening themselves to foreign investment would lead to a new form of domination, the domination by large multinationals. That is why most of these countries went for 'protectionist' economic policy with ***import substitution*** as one method, side by side. But by the 1970s, the world was having convincing proofs that the socialist as well as the planned economies[1] were inclined to follow their kind of development strategy—because either they had very slow and lower growth rates or were stagnating. The experiences of these economies gave rise to a new ideology which is popular as the ***'Washington Consensus'***.

2. Washington Consensus

By the early 1980s, a new development strategy emerged. Though it was not new, it was like the old idea getting vindicated after failure of a comparatively newer idea. After the world recognised the limits of a state-dominated economy arguments in favour of the market, i.e. the private sector, was

promoted emphatically. Many countries shifted their economic policy just to the other extreme arguing for a minimal role of the government in the economy. Governments of the socialist or the planned economies were urged/suggested to privatise and liberalise, to sell off state-owned companies and eliminate government intervention in the economy. These governments were also suggested to take the measures which could boost the aggregate demand in the economy (***i.e. macroeconomic stability measures***). The broad outlines of such a development strategy were called as the ***Washington Consensus***[2]**.**

This consensus is broadly termed as the popular meaning of the 'economic reform' followed by almost all the socialist, the communist and the planned developing economies during the 1980s in one form or the other[3] -the term economic reform got currency around the world during this period. The term was usually seen as a corollary of promoting 'naked capitalism', openness in the economy and an open attitude towards foreign investments, etc. The Governments of the developing economies were criticised by the political parties in the opposition and the critiques for being soft to the dictates of the IMF and the WB and becoming a party to promote 'neo-imperialism'.

But these policies, in many cases proved little better than the previous policies in promoting growth over an extended period of time. But somehow a mood in favour of the market economy had gained ground. The United Kindom under Mrs. Thatcher had gone for politically most vocal privatisation moves without any political debates (The only such example of privatisation moves among the democracies, till date).[4] It should be noted here that after the Great Depression of 1929 a 'strong state intervention' was suggested (by J.M. Keynes) and such a policy did really help the Euro-American countries to mitigate the crisis. The favour for the state intervention in the economy was being reversed by the Washington Consensus. But soon this consensus was also to be replaced by another development strategy.

3. Mixed Economy

By the mid-1990s, it had become increasingly clear that neither of the extremes—the Washington Consensus or the state-led planned economy—were the ultimate strategies of development[5]. The success achieved by the East Asian economies even if we take into account their setback due to the financial crisis of 1997–98, stands out in marked contrast to the experiences of the other economies of the time who were following the Washington Concensus strategy of the planning model.[6] The East Asian economies have not only been able to propel higher growth rates but they have been greatly successful in reducing poverty, promoting education and healthcare, too.

The East Asian economies had promoted a development strategy which had its most distinctive feature as the balance they were able to strike between the roles of the state/government and the market/the private sector in their economies. This was really a new kind of the mixed economy which was never permanently inclined towards either state intervention or the free market, but always a balanced mix of the state and the market according to the requirement of the socioeconomic situation of the economy. The East Asian countries had pursued market-oriented policies that encouraged development of the private sector—augmenting and governing the market, not replacing it.[7]

Technically speaking, shifting of economic policy of a country from one to the other above-given three 'alternative development strategies' is economic reform. But in the history of the world

economy, it was inclination of the economies towards the market economy, which have been referred as economic reforms. In the Indian case, economic reform has been used always in this sense. Here, one should note that when India started the programme of economic reforms in the early 1990s, the world view was in favour of privatisation, liberalisation, de-nationalisation, etc. as the main plank of economic reforms. But by the mid-1990s, not only the world view has polarised in favour of the 'mixed economy' but one another change was about to sweep the world economies i.e. the favour for globalisation sponsored by the World Trade Organisation (WTO). Now, the developing economies (mixed economies with planning as their development strategy) as well as the transition economies (Russia and the whole Eastern Europe, China)—who were already promoting the market-oriented reform process were faced with a dilemma. To prosper and compete in the globalising environment while they needed immediate liberation from their state-dominated mode of economies at one hand they also needed to strike a balance between the state and the market on the other. Each one of them tried to strike the balance in their own way with mixed results. In India, the Governments have not been able to convince the masses that the economy needs reforms and the attempted reforms will benefit all. In every election since the reforms of 1991, the voters have not supported a pro-reform government. Though the process of economic reforms started in India with the slogan ***'reforms with human face'***—the slogan has utterly failed to garner the empathy of masses. We may hope that in coming times the masses will start connecting to reforms and are able to get the message clear i.e. reforms are to benefit all.

ECONOMIC REFORMS IN INDIA

On July 23, 1991, India launched a process of economic reforms in response to a fiscal and balance-of-payment (BoP) crisis. The reforms were historic and were going to change the very face and the nature of the economy in the coming times. The reforms and the related programmes are still going on with changing emphasis and dimensions but they are criticised as being slow ever since the UPA Government came to power in May 2004. Back in the mid-1980s, the Governments had taken its first steps to economic reforms. While the reforms of the 1980s witnessed rather limited nature of deregulation and 'partial liberalisation of only a few aspects of the existing control regime, the reforms started in early 1990s in the fields of industries, trade, investment and later to include agriculture, were much 'wider and deeper'[8]. Though liberal policies were announced by the Governments during the reforms of the 1980s itself, with the slogan of 'economic reforms' it was only launched with full conviction in the early 1990s. But the reforms of the 1980s which were under the influence of the famous ***'Washington Consensus'*** ideology had a crippling impact on the economy. The whole Seventh Plan (1985–90) promoted further relaxation of market regulations with heavy external borrowings to increase exports (as the thrust of the policy reform). Though the thrust increased the growth rate led by higher industrial growth rate (riding on costly imports supported by foreign borrowings which the industries would not be able to pay back and service) it also led to a substantial increase in foreign indebtness that played a major role in the BoP crisis of 1991.[9] The crisis was immediated by the First Gulf War (1991) which had two-pronged negative impact on the Indian foreign exchange (forex) reserves. First, the war led the oil prices to go upward forcing India to use its forex reserves in comparatively shorter period and second, the private remittances from

Indians working in the Gulf region fell down fast (due to their emergency evacuation)—both the crises were induced by a single cause i.e. the Gulf War. But the balance of payments crisis also reflected deeper problems of rising foreign debt, a fiscal deficit of over 8 per cent of the GDP and a hyper-inflation (over 13 per cent) situations.[10]

The minority Government of the time had taken a highly bold and controversial step in the form of economic reforms criticised throughout the 1990s by one and all—right from the opposition in the parliament, to the communist parties, to the industrial houses, the business houses, media, experts and by the masses also. By now as the benefits of the reforms have accrued to many, the criticism has somewhat calmed down but still the reform process is considered as 'anti-poor' and 'pro-rich' by at least the masses—the people who decide the political mandate for the country to rule. At least one belief is followed by everybody i.e. the benefits of reforms are not tickling to the masses (the ***'aam aadami'***) with the desirable pace.[11] The need of the hour is to go for 'distributive growth' though the reform has led the economy to a higher growth path.

Obligatory Reform

Similar reform process started by some other economies since the 1980s were voluntary decisions of the concerned countries. But in the case of India it was an involuntary decision taken by the Government of the time in the wake of the BoP crisis. Under the Extended Fund Facility (EFF) programme of the IMF, countries get external currency support from the fund to mitigate their BoP crisis, but such supports have some obligatory conditionalities put on the economy to be fulfilled. There are no set rules of such conditions already available with the IMF though they are devised and prescribed to the BoP-crisis-ridden economy at the time of need. A point needs to be referred here is that the conditionalities put upon India were of the nature which required all the economic measures to be formulated by them. It means that the reforms India carried or is carrying out at present were neither formulated by India nor mandated by the public. Yes, there was a large section of experts inside and outside the Government who believed in similar economic measures to bring the economy on the right path. Some of them were arguing the same since 1970s itself while many other experts believed in them since the mid-1980s[12]. But why after all was the Rao-Manmohan Government credited to start the reform process in India? It is because they thought it suitable to follow and make it politically possible in India. Imagine, a government proposing to sell the state-owned companies to the private sector or closing them down in a country which has been convinced that these companies will be the 'temples of modern India'. The Masses were convinced that the Government has bowed down to the dictats of the IMF, the imperialist forces, the multinationals, etc. Even today such feelings are there in several quarters of the economy. The politics of the economic reforms damaged India more than the reform has benefitted the country. It would not be an exaggeration if we conclude economic reforms had no political consensus. Political parties in India are divided on the issue of reforms—the parties together with the masses lack the level of political maturity required for the success of the reforms programme. It is right, democratic maturity comes to a multi-party political system but it takes time. It takes even more time where masses are unaware and ignorant. The emotional issues of religion, caste, etc. play their own roles in such situation.

The **IMF conditions** put forth for India were as under:

(i) Devaluation of the rupee by 22 per cent (which was effected in two phases and the Indian

rupee fell down from Rs. 21 to Rs. 27 per US dollar).

(ii) Drastic reduction in the peak import tariff from the prevailing level of 130 per cent to 30 per cent (India completed it by 2000–01 itself and now it is voluntarily cut to the level of 15 per cent).

(iii) Excise duties (i.e CENVAT now) to be hiked by 20 per cent to neutralise the revenue short falls due to the custom cut (a major tax reform programme was launched to streamline, simplify and modernise the Indian tax structure which is still going on).

(iv) All government expenditure to be cut down by 10 per cent, annually (i.e cutting the cost of running the government and denotes, interests; pays, pension and the PF; subsidies. A pressure on the Government to consolidate the fiscal deficit and go for fiscal prudence).

Though India was able to pay back its IMF dues in time, the structural reform of the economy was launched to fulfill the above-given conditions of the IMF. The ultimate goal of the IMF was to help India bring about equilibirium in its BoP situation in the short-term and go for macroeconomic and the structural adjustments so that in future the economy faces no such crisis.

There was enough scope for the critics to take India's economic reforms as prescribed and dictated by the IMF. The process of economic reforms in India had to face severe criticism from almost every quarter of the economy concerned. although the reforms were aimed to boost growth and deliver competitiveness to the economy.[13]

Reform Measures

The economic reform programme, that India launched, consisted of ***two*** categories of measures:

(i) Macroeconomic Stabilisation Measures:

It includes all those economic policies which intend to boost the aggregate ***demand*** in the economy—be it domestic or external. For the enhanced domestic demand, the focus has to be on increasing the purchasing power of the masses which entails an emphasis on the creation of the gainful and quality employment opportunities.

(ii) Structural Reform Measures:

It includes all the policy reforms which have been initiated by the government to boost the aggregate supply of goods and services in the economy. It naturally entails unshackling the economy so that it may search for its own potential of enhanced productivity and production. For the purchasing capacity of the people to be increased, the economy needs increased income which comes from increased levels of activities. Income so increased is later distributed among the people whose purchasing power has to be increased—this will take place by properly initiating a suitable set of the macroeconomic policies. For the income to get distributed among the target population, it takes time but the efforts a government initiates to increase the supply i.e. increasing production becomes visible soon. As production is done by the producers (i.e the capitalists), *prima facie* the structural reform measures look 'pro-rich' and 'pro-industrialist' or 'pro-capitalist', known with different names. Ignorant people easily get swayed by the logic that everything which is 'pro-rich' has to be

necessarily ‘anti-poor’. But it was not the case with the process of economic reforms. Unless the economy is able to achieve higher growth (i.e. income) wherefrom the purchasing power of the masses will be enhanced? And increased income takes time to reach everybody. If the economy lacks political stability, this process takes even more time due to short-term goals set by the unstable and frequently changing governments—the exact case is with India.

The LPG

The process of reforms in India has to be completed via three other processes namely, liberalisation, privatisation and globalisation, popular by their short-form—the LPG. These three processes specify the characteristics of the reform process India initiated. Precisely seen, liberalisation shows the ***direction*** of reform, privatisation shows the ***path*** of reform and globalisation shows the ultimate ***goal*** of the reform. However, it would be useful to see the real meanings of these terms and the exact sense in which they are being used worldwide and particularly in India.

LIBERALISATION

The term liberalisation has its origin in the political ideology ‘liberalism’ which took its form by early nineteenth century (it developed basically in the previous three centuries). The term is sometimes protrayed as a ***meta-ideology*** capable of embracing a broad range of rival values and beliefs. The ideology was the product of the breakdown of feudalism and the growth of a ***market*** or ***capitalist*** society[14] in its place which became popular in economics via the writings of Adam Smith (its founding father in the USA) and got identified as a principle of ***laissez-faire.***[15]

The term liberalisation will have the same connotation in economics as its root word liberalism has. Pro-market or pro-capitalistic inclination in the economic policies of an economy is the process of liberalisation. We see it taking place in the whole Euro-America in 1970s and particularly in the 1980s.[16] The most suitable example of this process could be China of the mid-1980s when it announced its ***‘open door policy’.*** Though China lacks (even today) some trademark traits of liberalism, as for example individualism, liberty, democratic system, etc. still China was called a liberalising economy.

We may take an example from the history of the world economy—putting the USA of the early 20th century and the communist China on the two poles of the scale—thus representing the best historical example of the liberal economy and China being the best example of the ‘illiberal’ economy. With the USA on the south pole and China on the north any policy movement towards ‘the south’ is ‘liberalisation’. The movement from the south to the north will be known as ‘illiberalisation’.

It means that the process of decreasing traits of a state economy and increasing traits of a market economy is liberalisation. Similarly, the opposite will be the process of illiberalisation. Technically speaking, both the processes will be known as the processes of economic reforms, since ‘reform’ as a term does not say anything about the ‘direction’. All the economic reforms in the world have been from the ‘north to the south’. Similar is the case with the process of liberalisation.

It means, in the Indian case the term liberalisation is used to show the direction of the economic

reforms—with decreasing influence of the state or the planned or the command economy and increasing influence of the free market or the capitalistic economy. It is a move towards capitalism. India is attempting to strike its own balance of the 'state-market mix'. It means, even if the economic reforms have the direction towards market economy it can never be branded a blind-run to capitalism. Since the economy was more like the state economy in the former years, it has to go for a greater degree of mix of the market. But in the long run, Liberalism curtails the powers of Parliaments.[17]

PRIVATISATION

The decades of the 1980s and 1990s witnessed a 'rolling back' of the state by the governments, especially in the USA and the UK under the inspiration of the New Right priorities and beliefs.[18] The policies through which the 'roll back' of the state was done included deregulation, **privatisation** and introduction of market reforms in public services. Privatisation at that time was used as a process under which the state assets were transferred to the private sector.[19] The root of the term privatisation goes to this period which got more and more currency around the world once the East European nations and later the developing democratic nations went for it. But during the period several connotations and meanings of the term 'privatisation' have developed. We may see them as follows:

(i) Privatisation in its purest sense and lexically means **de-nationalisation**[20] i.e. transfer of the state ownership of the assets to the private sector to the tune of 100 per cent. Such bold moves took place only once anywhere in the world without any political fallouts—in the early 1980s of the UK under the Thatcher regime. This route of privatisation has been avoided by almost all democratic systems. In the mid-1990s some west European nations—Italy, Spain and France—besides the USA went for such moves.[21] India never ventured into any such privatisation move.

(ii) The sense in which privatisation has been used is the process of **disinvestment** all over the world. This process includes selling of the shares of the state-owned enterprises to the private sector. Disinvestment is de-nationalisation of less than 100 per cent ownership transfer from the state to the private sector. If an asset has been sold out by the Government to the tune of only 49 per cent the ownership remains with the state though it is considered privatisation. If the sale of shares of the state-owned assets has been to the tune of 51 per cent, the ownership is really transferred to the private sector even then it is termed as privatisation.

(iii) The third and the last sense in which the term privatisation has been used around the world, is very wide. Basically, all the economic policies which directly or indirectly seem to promote the expansion of the private sector or the market (economy) have been termed by the experts and the governments as the process of privatisation. We may cite a few examples from India —de-licencing and dereservatrion of the industries, even cuts in the subsidies, permission to foreign investment, etc.[22]

Here we may connect liberalisation to privatisation in India. Liberalisation shows the direction of reform in India i.e. inclination towards the dominance of market. But how will it be achieved? Basically, privatisation will be ***the path*** to reform. It means, everything which includes promotion to the 'market' will be the path of the reform process in India.

GLOBALISATION

The process of Globalisation has always been used in economic terms though it has always taken the political and cultural dimensions. Once economic changes occur it has several sociopolitical manifestations.[23] Globalisation is generally termed as 'an increase in economic integration among nations'[24] . Even before several nation-states were not even born, the countries around the world had gone for globalisation i.e. 'a closer integration of their economies'.[25] This globalisation lasted from 1800 to almost 1930, interrupted by the Great Depression and the two Wars which led to retrenchment and several trade barriers were erected since early 1930s.[26]

The concept was popularised by the Organisation of Economic Cooperation and Development (OECD) in the mid-1980s again after the Wars. In its earlier deliberation, the organisation had defined globalisation in a very narrow and business-like sense— ***'any cross-border investment by an OECD company outside its country of origin for its benefit is globalisation'.*** After this summit of the OECD, proposals for replacing the GATT by the WTO were pushed by the developed economies of the world, better known as the starting of the Uruguay Round of GATT deliberations which ends in the Marrakesh (1994) with the birth of WTO'. In the meantime, the OECD had defined (1995) globalisation officially, too—"a shift from a world of distinct national economies to a global economy in which production is internationalised and financial capital flows freely and instantly between countries."[27]

The official meaning of globalisation for the WTO is movement of the economies of the world towards ***"unrestricted cross border movements of goods and services, capital and the labour force".*** It simply means that the economies who are signatories to the process of globalisation (i.e. signatories to the WTO) for them there will be nothing like foreign or indigenous goods and services, capital and labour. The world becoming flat and level-playing field emerging in the due process of time.[28]

For many political scientists (which is today a very dominant force in the world), globalisation is the emergence of a situation when our lives are increasingly shaped by the events that occur at a great distance from us about which the decisions are not taken by our conscious self. One section of experts believe that globalisation subordinates the state while the other section argues that the local, the national and global events constantly interact under it without any sfubordination of one by the other. Rather, globalisation highlights the deepening as well as broadening of the political process in this sense.[29]

India became one of the founding members of the WTO and was obliged to promote the process of globalisation, though its economic reforms started with no such obligation. It is a different thing that India started the process of globalisation right after the reforms were started in 1991, itself.[30]

Now we may connect the three simultaneous processes—the LPG with which India launched its reform programme. The process of liberalisation shows movement of the economy towards the market economy, privatisation is the path/route through which it will travel to realise the ultimate 'goal' i.e. globalisation.

It should be noted here that the Indian idea of globalisation is deeply and frequently inclined towards

concept of the welfare state which keeps coming in the day to day public policy as an emphatic reference. The world, including the IMF, the WB and the developed nations have now increasingly shown their recognition to the fact that the official goal of globalisation of the world economies would not take place without giving the poor of the world a better standard of living. Even if globalisation is complete without including almost one-fifth of the world population, the poor, will it be called development of the world?

GENERATIONS OF ECONOMIC REFORMS

Though there were no such announcements or proposals while India launched its reforms in 1991, in the coming times, many 'generations' of reforms were announced by the Governments[31]. A total of ***three*** generations of the reforms have been announced till date while experts have gone to suggest the ***fourth*** generation, too. We may substantiate the components of the various generations of reforms to properly understand the very characteristics and the very nature of the reform process in India, as given below:

First Generation Reforms (1991–2000)[32]

It was in the year 2000–01 that the Government, for the first time, announced the need for the Second Generation of economic reforms and it was launched the same year. The ones which had been initiated by then (i.e from 1991 to 2000) were called by the Government as the reforms of the first Generation. The broad co-ordinates of the First Generation of reforms may be seen as under:

(i) Promotion to Private Sector:

This included various important and liberalising policy decisions i.e. 'de-reservation' and 'de-licencing' of the industries, abolition of the MRTP limit, abolition of the compulsion of the phased-production and conversion of loans into shares, simplifying environmental laws for the establishment of the industries, etc.

(ii) Public Sector Reforms:

The steps taken to make the public sector undertakings profitable, efficient, their disinvestment (*token*), their corporatisation, etc. were the major parts of it.

(iii) External Sector Reforms:

They consisted of policies like—abolishing quantitative restrictions on import, switching to the floating currency regime of exchange rate, announcing full current account convertibility, reforms in the capital account, permission to foreign investment (direct as well as indirect), promulgation of a liberal foreign exchange management act (the FEMA replacing the FERA), etc.

(iv) Financial Sector Reforms

Several reform initiatives were taken up in the areas of the banking sector, capital market, insurance, mutual funds, etc.

(v) Tax Reforms

This consisted of all the policy initiatives directed towards simplifying, broadbasing, modernising, checking evasion, etc.

A major re-direction was ensued by this generation of reforms in the economy—the 'command' type of the economy moved strongly towards a market-driven economy, private sector (domestic as well as foreign) to have greater participation in the future.

Second Generation Reforms (2000–01 onwards)[33]

The Government launched this generation of the reforms in the year 2000-01. Basically, the reforms India launched in the early 1990s were not taking place as desired and a need for another set of reforms was felt by the Government which were initiated with the title of the Second Generation of economic reforms. The reforms of this generation were not only deeper and delicate but required a higher political will power from the governments. The major components of the reform are as given below:

(i) Factor Market Reforms:

Considered as the 'backbone' for the success of the reform process in India itself, it consists of dismantling of the Administered Price Mechanism (APM). There were many products in the economy whose prices were fixed/regulated by the Government viz. petroleum, sugar, fertilizers, drugs, etc. Though a major section of the products under the APM were produced by the private sector, they were not sold on the market principles which hindered the profitability of the manufacturers as well as the sellers and ultimately the expansion of the concerned industries leading to a demand-supply gap. Under market reforms these products were to be brought into the market fold.

In the petroleum segment now only kerosene oil and the LPG remained under the APM while petrol, diesel, lubricants have been phased out. Similarly, the income tax paying families don't get sugar from the TPS on subsidies; only urea, among the fertilizers, remain under APM while many drugs have also been phased out of the mechanism. Opening the petroleum sector for private investment, cutting down the burden of levy on sugar, etc. are now giving dividends to the economy. But we cannot say that the Factor Market Reforms (FMRs) are complete in India. It is still going on. Cutting down subsidies on the essential goods is a socio-political question in India. Till market-based purchasing power is not delivered to all the consumers, it would not be possible to complete the FMRs.

(ii) Public Sector Reforms:

The second generation of reforms in the public sector especially emphasises on the areas like greater

functional autonomy, freer leverage to the capital market, international tie-ups and greenfield ventures, disinvestment[34] (*strategic*), etc.

(iii) Reforms in the Government and Public Institutions:

This involves all those moves which really go to convert the role of the Government from the 'controller' to the 'facilitator' or the administrative reform, as it may be called.

(iv) Legal Sector Reforms:

Though reforms in the legal sector were started in the first generation itself, now it was to be deepened and newer areas were to be included—abolishing outdated and contradictory laws, reforms in the Indian Penal Code (CrPC), Labour Laws, Company Laws and enacting suitable Legal provisions for new areas like Cyber Law, etc.

(v) Reforms in the Critical Areas:

The second generation reforms also commit to suitable reforms in the infrastructure sector (i.e. power, roads, especially as the telecom has been encouraging), agriculture, agricultural extension, education and the healthcare, etc. These areas have been called by the Government as the ***'critical areas'***.[35]

These reforms have two segments. The first segment is similar to the Factor Market Reforms, while the second segment includes a broader dimension to the reforms viz. corporate farming, research and development in the agriculture sector (which was till now basically taken care of by the Government and needs active participation of the private sector), irrigation, inclusive education and the healthcare.

Other than the above-given focus of this generation of the reforms, some other important areas were also emphasised:

(a) **State's Role in the Reform** For the first time, an important role to the state was designed, in the process of economic reforms. All new steps of the reforms were now to be started by the state with the centre playing a supportive role.

(b) **Fiscal Consolidation** The area of fiscal consolidation though it was a major co-ordinate of reform in India since 1991 itself, gets a constitutional commitment and responsibility. The FRBM Act is passed by the Centre and the Fiscal Responsibility Act (FRAs) is followed by the states as an era of new commitments to the fiscal prudence starts in the country.

(c) **Greater Tax Devolution to the States** Though there was such a political tendency[36] by the mid-1990s itself, after the second generation reforms started, we see a visible change in the central policies favouring greater fiscal leverage to the states. Even the process of tax reforms takes the same dimension. Similarly, the Finance Commissions as well as the Planning Commission start taking greater fiscal care of the states. And for the first time the states had a net revenue surplus collections in the fiscal 2007–08.[37]

(d) **Focussing on the Social Sector** The social sector (especially the healthcare and education) gets increased attention by the Government with manifold increases in the allocations as well

as show of a greater compliance to the performance of the development programmes.

We see mixed results of the second generation reforms though the reforms continue.

Third Generation Reforms

Announcement of the third generation of reforms were made on the margins of the launching of the Tenth Plan (2002–07). This generation of reforms commits to the cause of a fully functional Panchayati Raj Institution (PRIs), so that the benefits of the economic reforms, in general, can reach the grass-root level.

Though the constitutional arrangements for a decentralised developmental process was already effected in the early 1990s, it was in the early 2000s that the Government gets convinced of the need of the 'inclusive growth and development'. Till the masses are not involved in the process of development, the development will lack the 'inclusion' factor, it was concluded by the Government of the time. The Eleventh Plan goes on to ratify the same sentiments (though the political combination at the centre has changed) and view regarding the need for the third generation of reforms in India.

Fourth Generation Reforms

This is not an official 'generation' of reform in India. Basically, in early 2002, some experts coined this generation of reforms which entail a fully 'information technology-enabled' India. They hypothesised a 'two-way' connection between the economic reforms and the information technology (IT)—with each one reinforcing the other.

Note

The different generations of the economic reforms in India should not be seen as the completion/ending of the former and commencement of the later generations of the reform. Basically, all of the Generations are going on at present simultaneously, so that the goal of reforming the economy is objectified. The various generations of reforms in India also verify the fact that 'reform' is a continuous process which needs 'fine-tuning' in accordance with the changed situations. Reform is not the aim of the economy but reforming the economy is the aim. Reform is a means to an end.

We saw a general decline in the government's eagerness towards furthering the cause of economic reforms once the UPA came to power in 2004 – largely due to the nature of the coalition which included the Left Front supporting it from outside (outside support is considered the weakest and the most delicate thing for a government by the world political thinkers and analysts). The returning of the UPA to power in 2009, with a bit different coalition partners could not ensue any new pace regarding furthering the reform process. Almost everyone, including the major industrial houses remarked the policy-paralysis of the government as the cause of hurting the pace of growth in the economy. The government document[38], *Economic Survey 2011-12*, says that though it is hard to quantify and for that reason is contestable, there has been seen a slackening in the pace of reforms – one consequence of increased awareness of high-profile corruption scandals in different parts of India and welcome civil-society activism has been a sense of caution among civil servants in taking crucial decisions. Since one way to avoid the charge of an ill-considered or, worse, bad-intentioned decision is to take

no decision, it is arguable that some civil servants have resorted to precisely this strategy, concludes the Survey. This would cause a slowdown in decision making. In addition, coalition politics and federal considerations played their role in holding up economic reforms on several fronts, ranging from diesel and LPG pricing and taxation reform like the goods and services tax (GST) and direct taxes code (DTC), to FDI in retail and reform of the APMC Act, says the document.

Other than the above-discussed reasons the recent financial developments in the global economy, specially, the US and European economies which followed in the aftermath of the *US Sub-prime Crisis* also placed an ideological dilemma in front of India. This fact has been given no attention by the contemporary Indian media or the intelligentia, probably due to its academic nature (which can hardly be understood by the masses, the voters, who had already numerous reservations regarding the economic reform process followed by the GoI!)[39]. The so-called affinity to the idea of the ***Washington Consensus*** among the Euro-American nations has now almost lost ground in the region where it was proposed, cemented and propagated around the world through the IMF/WB. What should be the course of action in future towards greater dependence on the private capital is still to be decided by the world financial body in clear terms. Meanwhile, a certain degree of liberal attitude towards promoting the process of economic reforms has been suggested by the IMF/WB to India[40] to which the GoI has given its nod. The ***Economic Survey 2012-13*** has highlighted the need of continuing the process of economic reforms in the country – it has shown concern on the issue of the undue time which the India political system takes to reach at a consensus – specially while discussing the issue of the 'demographic dividend' – where it has cautioned that if India fails to remain in tune with the changing times of the global economy the aspirations of the 'dividend' may remain just a dream!

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1. There were many developing non-socialist countries which also accepted the economic planning as their development strategy (France should not be counted among them as it was a developed economy by then). These countries were following the 'mixed economy' but their form was closer to the command economy i.e. the state economy or the socialist economy.
2. As the strategy was advocated by the IMF, the WB and the US Treasury (i.e US Ministry of Finance) all located in Washington, therefore it got such a name.
3. Without changing the broad contours of economic policy, the Government in India had also come under the influence of this consensus and a great many ***liberal*** policies were followed up by the country (during the Rajiv Gandhi's regime) during the 1980s.
4. ***Collins Dictionary of Economics,*** Glasgow, 2006, pp. 417–18.
5. ***The East Asia Miracle,*** WB, Washington, 1993.
6. ***The East Asian Miracle,*** WB, Washington, 1993.
7. As is concluded by Stiglitz and Walsh, p. 800, op. cit.
8. Jeffrey D. Sachs, Ashutosh Varshney and Nirupan Bajpai, ***India in the Era of Economic Reforms,*** Oxford University Press, N. Delhi, 1999, p. 1.
9. J. Barkley Rosser, Jr. and Marina V. Rosser, ***Comparative Economics in a Transforming World Economy,*** Prentice Hall of India, N. Delhi, 2nd Ed., 2005, p. 469.
10. Vijay Joshi and I.M.D. Little, ***India's Economic Reforms, 1991–2001,*** Oxford, Clarendon Press, 1996, p. 17.
11. The feeling is even shared by the Government of the present time. One may refer to the similar open acceptance by India's Minister of Commerce at the Davos Summit of the World Economic Forum (2007). In an interview to the ***CNN-IBN*** programme the Cabinet Minister for Panchayat Raj, and the North East (Mani Shankar Aiyar) on 20th May 2007 opined that benefits of higher growth are going to the selected 'classes' and not to the 'masses'.

12. The Seventh and the Eight Plans have many such suggestions to give to the Governments of the time, especially the latter Plan has called for the same nature of the reform process, very clearly.
13. ***Economic Survey, 1991–92 & New Industrial Policy, 1991;*** GoI, New Delhi.
14. Andrew Heywood, ***Politics,*** Palgrave, New York, 2002, p. 43.
15. Robert Nisbet, ***Prejudices: A Philosophical Dictionary,*** Harvard University Press, Massachusetts, 1982, p. 211.
16. ***Economics: Making Sense of the Modern Economy,*** The Economist, London, 1999, pp. 225–26.
17. J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, pp. 123,178.
18. Andrew Heywood, p.100, op.cit.
19. Stiglitz and Walsh, p. 802–3, op.cit.
20. Collins, Oxford, Penguin, ***Dictionary of Economics,*** relevent pages.
21. Samuelson and Nordhaus, ***Economics,*** p.199, op.cit.
22. New Industrial Policy, 1991 & several documents of GoI since then.
23. Talcott Parsons, ***The Structure of Social Action***, McGraw-Hill, New York, 1937.
24. Samuelson and Nordhaus, ***Economics,*** p. 32, op.cit.
25. Stiglitz and Walsh, ***Economics,*** p. 804, op.cit.
26. Thomas L. Friedman, ***The World is Flat,*** Penguin Books, London, 2006, p. 9 & Stiglitz & Walsh, ***Economics,*** p. 804, op.cit.
27. As quoted in Andrew Heywood, ***Politics,*** p. 139, op.cit.
28. As Friedman shows in his best-seller, ***The World is Flat,*** op.cit.
29. As put by the ***Oxford's Dictionary of Politics,*** N. Delhi, 2004 pp. 222–25 & Andrew Heywood, ***Politics,*** p.138, op.cit.
30. It should be noted here that the whole Euro-America has already started promoting globalisation by the mid-1980s as the WTO deliberations at Uruguay started. The formation of the WTO only gave globalisation an official mandate in 1995 once it started its functions. It means, for India, globalisation was a reality by 1991 itself-one has to move as the dominant forces move.
31. It should be noted here that many economists believe the economic reforms of the mid-1980s as the First Generation. But the Governments of the time have not said anything like that. It was only in the year 2000–01 that India officially talks about the generations of reform for the first time.
32. Based on the ***New Industrial Policy, 1991*** & several ***Economic Surveys*** as well as many announcements by the Governments.
33. Based on the ***Economic Survey, 2000–01*** **and** ***Union Budget, 2001–02*** especially besides other official announcements by the GoI in the coming years.
34. Basically 'disinvestment' started in India in its 'token' form which is selling of the minority shares of the PSUs in its symbolic form. While in the 2nd Generation the Government went for the 'strategic' kind of it which basically involved the transfer of ownership of the PSUs from the state to the private sector—MFI2, BALCO, etc. being the firsts of such disinvestments. Once the UPA Government came to power in May 2004, the latter form of disinvestment was put on hold. We will discuss it in detail in the chapter ***Indian Industry.***
35. ***Economic Survey, 2000–01,*** MoF, GoI, N. Delhi, 2001.
36. We see it, especially, when the Coalition Government (i.e the UF Government) goes to amend the constitution so that the Alternative Method of Devolution (AMD) of the tax suggested by the Tenth Finance Commission becomes a law before the recommendations of the Eleventh Finance Commission. It should be noted that the AMD has increased the gross tax devolution to the states by a hefty 5 per cent.
37. The Comptroller and Auditor General, provisional report, May 2007.
38. ***Economic Survey 2011-12,*** MoF, GoI, N. Delhi, p. 30.
39. Various issues of ***The Economist*** and the ***Economic & Political Weekly*** between July, 2007 and May, 2012.
40. ***An IMF/WB Release*** dated 28th April, 2012, Washington DC, USA.

7

INFLATION AND BUSINESS CYCLE

*Fluctuations in the level of economic activity, alternating between periods of depression and boom, led by one prominent factor i.e. the expectations of the future demand – intertwined with the inflation – has always been a fascinating topic for economists.**

* *See Joseph E Stiglitz and Carl E Walsh, Economics, W W Norton, New Yok, USA, 4th Edition, 2006, pp. 494-496. Collins internet-linked Dictionary of Economics, Glasgow, Scotland, UK, 2006, pp. 48-49.*

SECTION-A

INTRODUCTION

For a layman, inflation is just price rise. It becomes a matter of everyday discussion if the prices of daily or weekly items start rising. Whatever impact it might be having on other areas of economy, inflation might take an ugly turn and lead to a political crisis—at least in the developing economies. India has seen governments thrown out of power in elections due to price rise in daily-use items. This is not the case in the developed economies, but inflation takes its political toll there, too. In the developed economies more aware and informed voters get carried away by the greater impact of higher or lower inflations in the elections. In this chapter, we will try to examine the concept of inflation from all possible dimensions to have an overall understanding.

DEFINITION

A rise in the general level of prices[1]; a sustained rise in the general level of prices[2]; persistent increases in the general level of prices[3] ; an increase in the general level of prices in an economy that is sustained over time[4]; rising prices across the board[5] —is inflation. These are some of the most common academic definitions of inflation. If the price of one good has gone up, it is not inflation, it is inflation only if the prices of ***most*** goods have gone up.[6]

When the general level of prices is falling over a period of time this is ***deflation***, the opposite situation of inflation. It is also known as ***disinflation***. But in contemporary economics, deflation or disinflation not used to indicate fall in prices. Instead, a price rise is termed a 'rise in inflation' and a price fall is termed a 'fall in inflation'. The terms deflation or disinflation have become part of the macroeconomic policy of modern governments. In policy terms, the terms show a reduction in the level of national income and output, usually accompanied by a fall in the general price level. Such a policy is often deliberately brought about by the governments with the objective of reducing, inflation and improving the balance of payments (BoP) by reducing import demand. As instruments of deflation, any policy includes fiscal measures (as for example, tax increase) and monetary measures (as for example, increase in interest rate).

The rate of inflation is measured on the basis of price indices which are of two kinds—Wholesale Price Index (WPI) and Consumer Price Index (CPI). A price index is a measure of the average level of prices, which means that it does not show the exact price rise or fall of a single good. The rate of inflation is the rate of change of general price level which is measured as follows:

Rate of inflation (year x) = Price level (year x) –Price level (year x-1) / Price level (year x-1)×100

This rate shows up in percentage form (%), though inflation is also shown in ***numbers*** i.e. ***digits***. A price index is a weighted average of the prices of a number of goods and services. In the index the

total weight is taken as 100 at a particular year of the past (the ***base year***), this when compared to the current year shows a rise or fall in the prices of current year, there is a rise or fall in the '100' in comparison to the base year—and this inflation is measured in digits.

Inflation is measured '***point-to-point***'. It means that the reference dates for the annual inflation is January 1 to January 1 of two consecutive years (not for January 1 to December 31 of the concerned year). Similarly, the weekly rate of inflation is the change in one week reference being the two consecutive last days of the week (i.e., 5 p.m. of two Fridays in India).

WHY INFLATION OCCURS

Economists have been giving different explanations throughout the 19th and 20th centuries for the occurrence of inflation—the debate still goes on. But the debate has certainly given us a clearer picture of inflation. We shall may see the reasons responsible for inflation in two parts—

I. Pre-1970s

Till the rise of the monetarist school, economists used to agree upon two reasons behind inflation:

(a) Demand-Pull Inflation

A mis-match between demand and supply pulls up prices. Either the demand increases over the same level of supply, or the supply decreases with the same level of demand and thus the situation of demand-pull inflation arise. This was a Keynesian idea. The Keynesian School suggests cuts in spending as the way of tackling excess demand mainly by increasing taxes and reducing government expenditure.

In practice, the governments keep tracking the demand-supply matrix to check such inflation. At times, the goods in short supply are imported, interest on loans increased, wages revised, depending upon the situation.

(b) Cost-Push Inflation

An increase in factor input costs (i.e. wages and raw materials) pushes up prices. The price rise which is the result of increase in the production cost is cost-push inflation. The Keynesian school suggested controls on prices and incomes as direct ways of checking such inflation and 'moral suasions' and measures to reduce the monopoly power of trade unions as the indirect measures (basically, cost-push inflations chiefly used to happen due to higher wage demanded by the trade unions during the era).

Today, the governments of the world use many tools to check such inflations—reducing excise and custom duties on raw materials, wage revisions, etc.

II. Post-1970s

After the rise of Monetaristic School of Economics in the early 1970s (***monetarism developed in***

opposition to post-1945 Keynesian idea of demand management), the school provided monetarist explanation for inflation, the so-called 'demand-pull' or the 'cost-push' which is excessive creation of money in the economy.

(a) Demand-Pull Inflation

For the monetarists a demand-pull inflation is creation of extra purchasing power to the consumer over the same level of production (which happens due to wage revisions at micro level and deficit financing at the macro level). This is the typical case of creating extra money (either by printing or public borrowing) without equivalent creation in production/supply i.e., 'too much money chasing too little output'—the ultimate source of demand-pull inflation.

(b) Cost-Push Inflation

Similarly for monetarists, 'cost-push' is not a truly independent theory of inflation—it has to be financed by some extra money (which is created by the government via wage revision, public borrowing, printing of currency, etc.). A price rise does not get automatically reciprocated by consumers' purchasing. Basically, people must have got some extra purchasing power created that's why they start purchasing at higher prices also. If this has not been the reason, people would have cut-down their consumption (i.e. overall demand) to the level of their purchasing capacity and the aggregate demand of goods would have gone down. But this does not happen. It means every cost-push inflation is a result of excessive creation of money—increasing money flow or money supply.

For monetarists, a particular level of money supply for a particular level of production is healthy for an economy. Extra creation of money over the same level of production causes inflation. They suggested proper monetary policy (money supply, interest rates, printing of currencies, public borrowing, etc.) to check the situations of inflationary pressure on the economy. Monetarists cancelled the Keynesian theory of inflation.

III. Measures to Check Inflation

From the above-given reasons for inflation and the measures to control it, which measure the governments of the world should apply in their policy making? In practice, governments around the world distanced themselves from this debate and have been taking recourse to all possible options while controlling inflation. The governments resort to following options to check rising inflation:

(i) As a ***supply side measure,*** the government may go for the import of goods which are in short-supply—as a short-term measure (as happened in India in the case of 'onion'[7] and meeting the buffer stock norm of wheat). As a long-term measure, governments go on to increase the production to matching the level of demand. Storage, transportation, distribution, hoarding are the other aspects of price management of this category.

(ii) As a ***cost side measure,*** governments may try to cool down the price by cutting down the production cost of the goods showing price rise with the help of tax breaks—cuts in the excise and custom duties (as happened in June 2003 in India in the case of crude oil and steel[8]). This helps as a short-term measure. In the long-term, better production process, technological

innovations, etc. are helpful. Increasing income of the people is the monetary measure to avoid the heat of such inflation.

(iii) The governments may take recourse to tighter monetary policy to cool down either the demand-pull or the cost-push inflations. This is basically intended to cut down the money supply in the economy by siphoning out the extra money (as RBI increases the Cash Reserve Ratio of bank in India)[9] from the economy and by making money costlier (as RBI increases the Bank Rate or Repo Rate in India)[10]. This is a short-term measure. In the long-run, the best way is to increase production with the help of the best production practices.

Again, this measure does not work if the price rise is taking place in the items of everyday use such as salt, onion, wheat, etc. (because nobody purchases such goods by borrowing from the banks). This measure helps if the prices are rising due to extra demand of cement, iron and steel, etc.

The governments might utilise any of the above or all the three measures to check and manage inflation in their day to day price management policy making.

TYPES OF INFLATION

Depending upon the range of increase, and its severity, inflation may be classified into three broad categories:

I. Low Inflation

Such inflation is slow and on predictable[11] lines which might be called small or gradual[12]. This is a comparative term which puts it opposite to the faster, bigger and unpredictable inflations. Low inflation takes place in a longer period and the range of increase is usually in 'single digit'. Such inflation has also been called as '***creeping inflation***'[12]. We may take an example of the monthly inflation rate of a country for six months being 2.3%, 2.6%, 2.7%, 2.9%, 3.1% and 3.4%. Here the range of change is of 1.1% and over a period of six months.

II. Galloping Inflation

This is a "***very high inflation***" running in the range of double-digit or triple digit (i.e. 20%, 100% or 200% a year)[13]. In the decades of 1970s and 1980s, many Latin American countries such as Argentina, Chile, and Brazil had such rates of inflation—in the range of 50 to 700 per cent. The Russian economy did show such inflation after the disintegration of the ex-USSR in the late 1980s.

Contemporary Journalism has given some other names to this inflation—*hopping inflation, jumping inflation* and *running or runaway inflation*.[14]

III. Hyperinflation

This form of inflation is '***large and accelerating***'[15] which might have the annual rates in million or even trillion[16] . In such inflation not only range of increase is very large but the increase takes place in a very short span of time, prices shoot up overnight.

The best example of hyperinflation that economists cite is of Germany after the First World War—in early 1920s. At the end of 1923, prices were 36 billion times higher than two years earlier.[17] This inflation was so severe that paper German currencies (the Deutsche Mark) were more valuable as stove fuel than as actual money.[18] Some recent examples of hyperinflation had been the Bolivian inflation of mid-1985 (24000 per cent per annum) and the Yugoslavian inflation of 1993 (20 per cent per day).[19]

Such an inflation quickly leads to a complete loss of confidence in the domestic currency and people start opting for other forms of money, as for example physical assets, gold and foreign currency (also known as “inflation proof” assets) and people might switch to barter exchange.[20]

OTHER VARIANTS OF INFLATION

Other than the three broad categories we analysed above, some other variants of inflation are also considered by governments in their policy making:

I. Bottleneck Inflation

This inflation takes place when the supply falls drastically and the demand remains at the same level. Such situations arise due to supply-side accidents, hazards or mismanagement which is also known as ‘structural inflation’. This could be put in the ‘demand-pull inflation’ category.

II. Core Inflation

This nomenclature is based on the inclusion or exclusion of the goods and services while calculating inflation. Popular in western economies, core inflation shows price rise in all goods and services excluding ***energy*** and ***food articles***. In India, it was first time used in the financial year 2000–01 when the Government expressed that it was under control—it means the prices of manufactured goods were under control.[21] This was criticised by experts on account of excluding food articles and energy out of the inflation and feeling satisfied on the inflation front. Basically, in the western economies, food and energy are not the problems for the masses, while in India these two segments play the most vital role for them.

OTHER IMPORTANT TERMS

Inflationary Gap

The excess of total government spending above the national income (i.e. fiscal deficit) is known as the inflationary gap. This is intended to increase the production level which ultimately pushes the prices up due to extra-creation of money during the process.

Deflationary Gap

The shortfall in total spending of the government (i.e. fiscal surplus) over the national income creates deflationary gap in the economy. This is a situation of producing more than the demand and the economy usually heads for a general slowdown in the level of demand. This is also known as the ***output gap***.

Inflation Tax

Inflation erodes the value of money and the people who hold currency suffer in this process. As the governments have authority of printing currency and circulating it into the economy (as they do in the case of deficit financing), this act functions as an income to the governments. This is a situation of sustaining government expenditure at the cost of people's income. This looks as if inflation is working as a tax[22]. That is how the term inflation tax is also known as ***seignorage***. It means, inflation is always the level to which the government may go for deficit financing—level of deficit financing is directly reflected by the rate of inflation.

It could also be used by the governments in the form of prices and incomes policy under which the companies pay inflation tax on the salary increases above the set level prescribed by the government.[23]

Inflation Spiral

An inflationary situation in an economy which results out of a process of wage and price interaction '***when wages press prices up and prices pull wages up***'[23] is known as the inflationary spiral. It is also known as the ***wage-price spiral***. This wage-price interaction was seen as a plausible cause of inflation in the year 1935 in the US economy, for the first time.[24]

Inflation Accounting

A term popular in the area of corporate profit accounting. Basically, due to inflation the profit of firms/companies gets overstated. When a firm calculates its profits after adjusting the effects of current level of inflation, this process is known as inflation accounting. Such profits are the real profit of the firm which could be compared to a historic rate of inflation (inflation of the base year), too.

Inflation Premium

The bonus brought by inflation to the borrowers is known as the inflation premium. The interest banks charge on their lending is known as the ***nominal*** interest rate which might not be the real cost of borrowing paid by the borrower to the banks. To calculate the real cost a borrower is paying on its loan, the nominal rate of interest is adjusted with the effect of inflation and thus the interest rate we get is known as the real interest rate. Real interest is always lower than the nominal interest if the inflation is taking place—the difference is the inflation premium.

Rising inflation premium shows depleting profits of the lending institutions. At times, to neutralise the effects of inflation premium, the lender takes the recourse to increase the nominal rate of interest.[25] In recent times, it was done by the Indian banks in July 2003 to ward off their depleting profits when

inflation had crossed the 7 per cent level—the level of inflation was threatening to deplete even the capital base of the banks. Since then the RBI has been following a tighter credit policy as inflation was going beyond the upper limit of its healthy range (i.e. 4–5 per cent in Indian case).

Phillips Curve

It is a graphic curve which advocates a relationship between inflation and unemployment in an economy. As per the curve there is a 'trade off' between inflation and unemployment i.e. an inverse relationship between them. The curve suggests that lower the inflation, higher the unemployment and higher the inflation, lower the unemployment.[26] During 1960s, this idea was among the most important theories of the modern economists. This concept is known after the economists who developed it—Alban William Housego Phillips (1914–75). Bill Phillips (popular name) was an electrical engineer from New Zealand and was an economist at the London School of Economics when propounded the idea. In ***'The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957'*** (published in *Economica* in 1958), he provided empirical evidence to support his ideas.[27]

By the early 1960s, an economic wisdom emerged around the world that by following a certain kind of monetary policy, unemployment could be checked forever and at the cost of a slightly higher inflation, unemployment could be reduced permanently. The Central Banks of the developed world started framing the required kind of monetary policies mixing the trade-off between inflation and unemployment. The idea became popular among the developing economies too by the late 1960s, though they were a bit confused, as most of them were fighting the menace of higher inflations (double digit) along with high level of unemployment.[28]

By the early 1970s, two American economists, Milton Friedman (Nobel Laureate, 1976) and Edmund Phelps challenged the idea of the Phillips Curve. According to them the trade-off between inflation and unemployment was only short-term, because once people came to expect higher inflation they started demanding higher wages and thus unemployment will rise back to its '***natural rate***' (the unemployment rate that occurs at full employment when the economy is producing at potential output, it is usually called the natural rate of unemployment[29]). They advocated that there was no long-term trade-off between inflation and unemployment. In the long run, monetary policy can influence inflation. They suggested that if monetary policy tried to hold unemployment below its natural rate, inflation will be rising to higher level—which is known as the **non-accelerating inflation rate of unemployment (NAIRU)** also.[30] The NAIRU is that rate of unemployment which is consistent with a constant rate of inflation. It means at NAIRU, the upward and downward forces on price (inflation) and wage (unemployment) neutralise each other and there is no tendency of change in the rate of inflation. We may say that the NAIRU is the lowest unemployment rate that an economy can sustain without any upward pressure on inflation rate.

Reflation

Reflation is a situation often deliberately brought by the government to reduce unemployment and increase demand by going for higher levels of economic growth[31]. Governments go for higher public expenditures, tax cuts, interest rate cuts, etc. Fiscal deficit rises, extra money is generally printed at

higher level of growth, wages increase and there is almost no improvement in unemployment.

Reflation can also be understood from a different angle—when the economy is crossing a cycle of recession (low inflation, high unemployment, low demand, etc.) and government takes some economic policy decisions to revive the economy from recession, certain goods see sudden and temporary increase in their prices, such price rise is also known as reflation.

Stagflation

A situation in an economy when inflation and unemployment both are at higher levels, contrary to conventional belief. Such a situation first arose in 1970s in the US economy (average unemployment rate above 6 per cent and the average rate of inflation above 7 per cent)[32a] and in many Euro-American economies. This took place as a result of oil price increases of 1973 and 1979 and anticipation of higher inflation. The stagflationary situation continued till the early 1980s. Conventional thinking that a trade-off existed between inflation and unemployment (i.e. Phillips curve) was falsified and several economies switched over to alternative ways of economic policies such as monetaristic and supply-side economics.

When the economy is passing through the cycle of stagnation (i.e. long period of low aggregate demand in relation to its productive capacity) and the government shuffles with the economic policy, a sudden and temporary price rise is seen in some of the goods—such inflation is also known as stagflation. Stagflation is basically a combination of high inflation and low growth.[32b]

Inflation Targeting

The announcement of an official target range for inflation is known as inflation targeting. It is done by the Central Bank in an economy as a part of their monetary policy to realise the objective of a ***stable*** rate of inflation[33] (the Government of India asked the RBI to perform this function in the early 1970s).

New Zealand was the first economy to go for inflation targeting in 1989[34] which has been followed by almost all economies since then. In the Indian case, the target ranges between 4 to 5 per cent which is also popular as the ***comfort zone*** of inflation in India.

By early 2013, there had been a debate on the issue of revising this 'comfort zone' for India (after such a suggestion coming from the ex-RBI Governor Y V Reddy at a Panel Discussion). But C Rangarajan, the present Chairman of the PM's Economic Advisory Council, suggested it to be kept at the present range of 4 to 5 per cent itself which has been set by the RBI. It should be noted that in 1998, Mr Rangarajan (while he was Governor, RBI) had called inflation rate at 6 to 7 per cent as 'acceptable level'. His idea of *threshold* was – at what level of inflation do adverse consequences set in? 'At that time, inflation level was as high as 10 -11 per cent, so cutting down inflation to 6 per cent was also very difficult that is why he suggested a higher 'comfort zone' (as was explained by Rangarajan to a recent media query)!

Skewflation

Economists usually distinguish between inflation and a relative price increase. 'Inflation' refers to a sustained, across-the-board price increase, whereas 'a relative price increase' is a reference to an

episodic price rise pertaining to one or a small group of commodities. This leaves a ***third phenomenon***, namely one in which there is a price rise of one or a small group of commodities over a sustained period of time, without a traditional designation. '**Skewflation**' is a relatively new term to describe this third category of price rise.

In India, food prices rose steadily during the last months of 2009 and the early months of 2010, even though the prices of non-food items continued to be relatively stable. As this somewhat unusual phenomenon stubbornly persisted, policymakers conferred on how to bring it to an end. The term 'skewflation' made an appearance in internal documents of the Government of India, and then appeared in print in the ***Economic Survey 2009-10***, GoI, MoF.

The **skewedness** of inflation in India in the early months of 2010 was obvious from the fact that food price inflation crossed the 20 per cent mark in multiple months, whereas wholesale price index (WPI) inflation never once crossed 11 per cent. It may be pointed out that the skewflation has gradually given way to a lower-grade generalised inflation. (with the economy in the middle of 2011 inflating at around 9 per cent with food and non-food price increases roughly at the same level).

Given that other nations have faced similar problems, the use of this term picked up quickly, with the ***Economist*** magazine *(Jan. 24, 2011),* in an article entitled *'Price Rises in China: Inflated Fears',* wondering if China was beginning to suffer from an Indian-style skewflation.

GDP Deflator

This is the ratio between GDP at *Current Prices* and GDP at *Constant Prices.* If GDP at Current Prices is equal to the GDP at Constant Prices, GDP deflator will be 1, implying no change in price level. If GDP deflator is found to be 2, it implies rise in price level by a factor of 2, and if GDP deflator is found to be 4 , it implies a rise in price level by a factor of 4. GDP deflator is acclaimed as a *better measure* of price behaviour because it covers all goods and services produced in the country (because the weight of services has not been equitably accounted in the Indian 'headline inflation' i.e. inflation at the WPI).

BASE EFFECT

It refers to the impact of the rise in price level (i.e. last year's inflation) in the previous year over the corresponding rise in price levels in the current year (i.e., current inflation). If the price index had risen at a high rate in the corresponding period of the previous year, leading to a high inflation rate, some of the potential rise is already factored in, therefore, a similar absolute increase in the Price index in the current year will lead to a relatively lower inflation rates. On the other hand, if the inflation rate was too low in the corresponding period of the previous year, even a relatively smaller rise in the Price Index will arithmetically give a high rate of current inflation. For example:

	Price Index				Inflation		
	2007	**2008**	**2009**	**2010**	**2007**	**2008**	**2009**
Jan	100	120	140	160	20	16.67	14.29

The index has increased by 20 points in all the three years – 2008, 2009, 2010. However, the inflation rate (calculated on 'year-on-year' basis) tends to decline over the three years from 20 per cent in 2008 to 14.29 per cent in 2010. This is because the absolute increase of 20 points in the price index in each year increases the *base year price index* by an equivalent amount, while the absolute increase in price index remains the same. The 'year-on-year' inflation is calculated by the formula –

Current Inflation Rate = [(Current Price Index – Last year's Price Index)] ÷ Last year's Price Index] x 100

EFFECTS OF INFLATION

There are multi-dimensional effects of inflation on an economy both at the micro and macro levels. It redistributes income; distorts relative prices; destabilises employment, tax, saving and investment policies and finally it may bring in recession and depression in an economy. We may have a brief and objective look on the effects of inflation as given below:

I. On Creditors and Debtors

Inflation redistributes wealth from creditors to debtors i.e. lenders suffer and borrowers benefit out of inflation. The opposite effect takes place when inflation falls (i.e. deflation).

II. On lending

With the rise in inflation, lending institutions feel the pressure of higher lending. Institutions don't revise the nominal rate of interest as the 'real cost of borrowing' (i.e. nominal rate of interest minus inflation) falls by the same percentage with which inflation rises.

III. On Aggregate Demand

Rising inflation indicates rising aggregate demand and indicates comparatively lower supply and higher purchasing capacity among the consumers. Usually, higher inflation suggests the producers to increase their production level as it is generally considered as an indication of higher demand in the economy.

IV. On Investment

Investment in the economy is boosted by the inflation (in the short-run) because of two reasons:

a. Higher inflation indicates higher demand and suggests enterpreneurs to expand their production level, and
b. Higher the inflation, lower the cost of loan (as shown above in no.II)

V. On Saving

Holding money does not remain an intelligent economic decision (because money loses value with

every increase in inflation) that is why people visit banks more frequently and try to hold least money with themselves and put maximum with the banks in their saving accounts. This is also known as the ***shoe leather cost***[35] of inflation (as it consumes the precious time of the people visiting the bank frequently tagging their shoe!). It means that saving rate increases. But this happens as a short-term effect of inflation. In the long-run, higher inflation depletes the saving rate in an economy. Just the opposite situation arises when inflation falls or shows falling traits with decreasing saving, in the short-run and increasing saving in the long-run, respectively.

VI. On Tax

On tax structure of the economy, inflation creates two distortions:

(a) Tax-payers suffer while paying their direct and indirect taxes. As indirect taxes are imposed ad valorem (***on value***), increased prices of goods make tax-payers to pay increased indirect taxes (like cenvat, vat, etc. in India).

Similarly, due to inflation, direct tax (income tax, interest tax, etc.) burden of the tax-payers also increases as tax-payer's gross income moves to the upward ***slabs*** of official tax brackets (but the real value of money does not increase due to inflation; in fact, it falls). This problem is also known as ***bracket creep*** — i.e. ***inflation-induced tax increases***[36]. Some economies (as in the US and many European countries) have ***indexed*** their tax provisions to neutralise this distortion on the direct tax payers.

(b) The extent to which tax collections of the government are concerned, inflation increases the nominal value of the gross tax revenue while real value of the tax collection does not compare with the current pace of inflation as there is a lag (***delay***) in the tax collection in all economies.

But governments get an advantage on their interest burden on their borrowings as inflation benefits borrowers. This benefit, however, depends upon the contemporary levels of fiscal deficit and the total national debt.

In the case of a government incurring high fiscal deficit (increased borrowing, printing currency) inflation functions as a tax i.e. ***inflation tax*** via which the government fulfills its expenditure by cutting down the expenditure and consumption of the people.

VII. On Exchange Rate

With every inflation the currency of the economy ***depreciates*** (loses its exchange value in front of a foreign currency) provided it follows the flexible currency regime. Though it is a comparative matter, there might be inflationary pressure on the foreign currency against which the exchange rate is compared.

VIII. On Export

With inflation, exportable items of an economy gain competitive prices in the world market. Due to this, the volume of export increases (keep in mind that the value of export decreases here) and thus export income increases in the economy. It means export segment of the economy benefits due to

inflation. Importing partners of the economy exert pressure for a stable exchange rate as their imports start increasing and exports start decreasing (see the next point).

IX. On Import

Inflation gives an economy the advantage of lower imports and import-substitution as foreign goods become costlier. But in the case of compulsory imports (i.e. oil, technology, drugs, etc.) the economy does not get this benefit and loses more foreign currency instead of saving it.

X. On Trade Balance

In the case of a developed economy, inflation makes trade balance favourable while for the developing economies inflation is unfavourable for their trade balance. This is because of composition of their foreign trade. The benefit to export which inflation brings in to a developing economy is usually lower than the loss they incur due to their compulsory imports which become costlier due to inflation.

XI. On Employment

Inflation increases employment in the short-run but becomes neutral or even negative in the long run (see the Phillips Curve and the NAIRU in the earlier sections).

XII. On Wages

Inflation increases the nominal (face) value of the wages while their real value falls. That is why there is a negative impact of inflation on the purchasing power and living standard of the wage employees. To neutralise this negative impact the Indian government provides ***dearness allowance*** to its employees twice a year.

XIII. On Self-employed

Inflation has a neutralising impact on the self-employed people in the short-run. But in the long run they also get affected as the economy as a whole gets affected.

XIV. On Economy

All the segments discussed above belong to an economy but we must know the overall short-term and long-term impact of inflation on an economy.

Experiences of the world economies in the late 1980s that a particular level of inflation is healthy for an economy. This specific level of inflation was called as the ‘range’ of inflation and every economy needs to calculate its own range. Inflation beyond both the limits of the range is never healthy for any economy. In the case of India it is considered 4 to 5 per cent which is also known as the ‘comfort zone’ of inflation in India. Similarly for Australia, New Zealand, the USA, Canada and the European Union the healthy range today is 1 to 3 per cent. This is why every economy today utilises ***inflation targeting*** as part of its monetary policy.

Inflation beyond the limits of the decided/prescribed range brings in recession to depressions. (We will see them in the Section B of this Chapter 'Business Cycle.)

INFLATION IN INDIA

Every economy calculates its inflation for efficient financial administration as the multi-dimensional effects of inflation make it necessary. India calculates its inflation on two price indices i.e. the wholesale price index (WPI) and the consumer price index (CPI). While the WPI-inflation is used at the macrolevel policy making, the CPI-inflation is used for micro level analyses. The inflation at the WPI is the inflation of economy. Both the indices follow the 'point-to-point' method and may be shown in ***points*** (i.e digit) as well as in ***percentage*** relative to a particular ***base year***.

Wholesale Price Index

The first index number of wholesale prices commenced in India for the week January 10, 1942. It was having the base week ending August 19, 1939 = 100 which was published by the office of the Economic Adviser to the Government of India (Ministry of Industry)[37]. Independent India followed the same series with more number of commodities included in the index. Several changes regarding inclusion of commodities, assigning them the logical weights took place in the coming times including revisions in the ***base years*** for the WPI. The WPI base year has been revised five times till date. The base years are as given below:

(i) 1952–53 Base Year (112 Commodities) issued from June 1952.
(ii) 1961–62 Base Year (139 Commodities) issued from July 1969.
(iii) 1970–71 Base Year (360 Commodities) issued from January 1977.
(iv) 1981–82 Base Year (447 Commodities) issued from January 1989.
(v) 1993–94 Base Year (435 Commodities) issued from July, 1999.
(vi) 2004-05 Base Year (676 Commodities) released in September 2011.

New Series of WPI

With the purpose of making inflation data in India more transparent, updated and similar to the practices among most of the economies, a ***Working Group for Revision of WPI Number*** was set up under the Chairmanship of the Planning Commission member, Prof. Abhijit Sen. In light of the recommendations the Government recently announced the *New Series of Wholesale Price Index.*

Headline inflation in India is measured in terms of Wholesale Price Index (WPI) and the Office of the Economic Adviser, Department of Industrial Policy & Promotion is entrusted with the task of releasing this index. WPI is an important statistical indicator, as various policy decisions of the Government, like inflation management, monitoring of prices of essential commodities etc., are based on it.

It is one of the key variables for monetary policy changes by the Reserve Bank of India. In addition to its role as a policy variable, WPI is also used by various departments for arriving at the escalation

costs of various contracts.

Considering the importance of WPI as a tool for various policy decisions, it is necessary to disseminate the most comprehensive, credible and accurate information, reflecting the realities of the present economic situation of the country. In order to capture the structural changes happening in the economy, the base year of WPI needs to be updated.

The Office of the Economic Adviser undertook the work relating to revision of the existing series of WPI (base 1993–94=100), which not only addressed the issue of change in base year, but also revised the entire commodity basket and the weighting diagram so as to better reflect the price trends in economy. The revised series of WPI was officially launched on **14 September, 2010** by the Ministry of Commerce & Industry.

Features of the Revised Series of WPI

A representative commodity basket comprising **676 items** has been selected in the new series (base 2004–05=100) as against 435 in the old series (base 1993–94=100) and weighting diagram has been derived for the new series consistent with the structure of the economy. There has been a substantial increase in the number of quotations selected for collecting price data for the above items. The number of price quotations for the new series is **5482** whereas in the old series, it was 1918.

The selection of the base year and the commodity basket was made on the basis of the recommendations of the Working Group set up specifically for this purpose. The Working Group was headed by Professor Abhijit Sen, Member, Planning Commission and included as its Members all stake-holders covering the users of the price data and the providers of the prices. The working group in its Technical Reports gave detailed recommendations with regard to the choice of the base year, the method of selection of items, preparation of weighting diagram and the collection of prices. The new index along with the base year and the commodity basket was also examined by Technical Advisory Committee (TAC) on Prices and Cost of Living based in Central Statistical Organisation. Before the launch of the new index, inter-departmental consultations were held and opinions obtained from Economic Advisory Council of the Prime Minister.

A comparative statement of weights, number of items and number of quotations between the **old series** and **new series** at Group level is as below:

Major Group / Group	*Weight*		*No. of items*		*No. of Quotations*	
	2004–05	*1993–94*	*2004–05*	*1993–94*	*2004–05*	*1993–94*
All Commodities	100.00	100.00	676	435	5482	1918
Primary Articles	20.12	22.02	102	98	579	455
Fuel & Power	14.91	14.23	19	19	72	72
Manufactured Products	64.97	63.75	555	318	4831	1391

Many new items have been included in the new series basket such as flowers, lemon and crude petroleum in **Primary Articles** and Ice cream, canned meat, palm oil, readymade/instant food powder, mineral water, computer stationary, leather products, scooter / motorcycle tyre, polymers, petrochemical intermediates, granites, marbles, gold and silver, construction machinery, refrigerators,

computers, dish antenna, transformer, microwave oven, communication equipments (telephone instruments), TV sets, VCD, washing machine and auto parts in **Manufactured Products**. A complete list of commodity basket including their weights in the new series of WPI with the base 2004-05 is available on the website www.eaindustry.nic.in.

Revised Series: New Initiatives

There has been a substantial increase, both in terms of the number of commodities and its geographical coverage, in the revised series of WPI (base 2004–05=100), as compared to the earlier revisions undertaken so far.[38] This would, undoubtedly, disseminate the more realistic and reliable data, facilitating better decision making and policy intervention.

The revised series of WPI (base 2004–05=100) has also addressed the issue of flow of regular data. The NIC unit of the Office of the Economic Adviser has developed an online data transmission mechanism, whereby, the manufacturing units can supply price data through internet. Also, an arrangement has been made with National Sample Survey Office (Field Operations Division) to get price data on regular basis. These measures have improved the flow of price data.

The launch of the new series of WPI with base year 2004–05 has been one of the major initiatives of the Ministry of Commerce & Industry.

Since **November 2009** the WPI data are already being released in the following way:

(i) the first set of data of WPI (for the *'Manufacturing Products'*) are released on monthly basis.

(ii) the second set of data of WPI (for the *'Primary Articles'* and *'Energy and Fuel Group'*) are released on the weekly basis.

Consumer Price Index

Other than the WPI, India calculates the inflation at the consumer level also, similar to all the economies of the world. As the consumers in India show wide differentiation of their choice of consumption, purchasing powers etc a single consumer price index (CPI) has not been possible yet which can encompass all the Indian consumers.[39]

Depending upon the socioeconomic differentiations among the consumers India has four differing sets of the CPI with some differentials in the basket of commodities allotted to them. Though these four types of the CPIs is proposed to be withdrawn in coming times, data for them are still released. A brief account of the four CPIs are as under:

I. CPI-IW

The Consumer Price Index for the industrial workers (CPI-IW) has 260 items (plus the services) in its basket with 2001 as the base year[40] (the first base year was 1958–59). The data is collected at 76 centres with one month's frequency and the index has a time lag of one month. It contains 120–160 commodities in its basket.

Basically, this index specifies the government employees (other than banks' and embassies' personnels). The wages/salaries of the central government employees are revised on the basis of the changes occurring in this index, the dearness allowance (DA) is announced ***twice*** a year. When the

Pay Commissions recommend pay revisions, the base is the CPI (IW).

II. CPI-UNME

The Consumer Price Index for the Urban Non-Manual Emplyees (CPI-UNME) has 1984–85 (first base year was 1958–59) as the base year and 146–365 commodities in the basket for which data is collected at the 59 centres in the country—data collection frequency is monthly with two weeks time lag.[41]

This price index has limited use and is basically used for determining dearness allowances (DAs) of employees of some foreign companies operating in India (i.e. airlines, communications, banking, insurance, embassies, and other financial services). It is also used under the Income Tax Act to determine ***capital gains*** and by the CSO (Central Statistical Organisation) for deflating selected service sector's contribution to the GDP at factor cost and current prices to calculate the corresponding figure at constant prices.

On the advice of its governing council the NSSO (National Sample Survey Organisation) is at present conducting a Family Living Survey (FLS) to obtain the profile of the present consumption pattern of urban non-manual employees so that the CPI (UNME) could be shifted to the present base year.

Presently, the CSO is also examining the possibility of constructing a consumer price index for the urban employees (a new index which might be like CPI - UE!).

III. CPI-AL

The Consumer Price Index for Agricultural Labourers (CPI-AL) has 1986–87 as its base year with 260 commodities in its basket. The data is collected in 600 villages with a monthly frequency and has three weeks time lag.

This index is used for revising minimum wages for agricultural labourers in different states. As the consumption pattern of agricultural labourers has changed since 1986–87 (its base year), the Labour Bureau proposes to revise the existing base year of this index. For the revision, the consumer expenditure data collected by the NSSO during its 61st NSS Round (2004–05) is proposed to be used.

The governments at the centre and states remain vigilant regarding the changes in this index as it shows the price impact on the most vulnerable segment of the society, this segment spends almost 75 per cent of its total income on the purchase of food articles. Governments' failure to stabilise the index in the long range can make them politically volatile and be translated into political debacles. That is why the FCI is always kept ready to supply cheaper foodgrains in the situations of any price rise.

IV. CPI-RL

There is yet another Consumer Price Index for the Rural Labourers (CPI-RL) with 1983 as the base year, data is collected at 600 villages on monthly frequency with three weeks time lag, its basket contains 260 commodities.

The agricultural and the rural labourers in India create an overlap i.e. the same labourers work as the rural labourers once the farm sector has either low or no employment scope. Probably, due to this

reason this index was dropped by the Government in 2001–02.[42] But after the government change at the Centre the index was revived again.[43]

New CPI

With the purpose of making inflation data in India more transparent, updated and similar to the practices among most of the economies, a ***Working Group for Revision of CPI Number*** was set up under the Chairmanship of the Planning Commission member, Prof. Abhijit Sen. In light of the recommendations the Government recently announced the *New Consumer Price Index*.

The Central Statistics Office (CSO) of the Ministry of Statistics & Programme Implementation announced that the new series of Consumer Price Index(CPI) numbers for Rural, Urban and Combined (Rural +Urban) on base 2010 (January to December)=100 taking all segments of rural and urban population for the month of January, 2011 was released by the Central Statistics Office for the States/UTs and all-India on 18th February, 2011.These indices will be available for five major groups namely Food, beverages and tobacco; Fuel and light; Housing; Clothing, bedding and footwear, and Miscellaneous.

Present CPI numbers do not encompass all the segments of the population in the country and as such they do not reflect the true picture of the price behaviour in the country. It is therefore necessary to compile a CPI which takes into account the consumption patterns of all segments of the population.

New series of CPI for urban areas

CPI (Urban) numbers are compiled at State/UT as well as at all-India level. Weighting diagrams (consumption patterns) of the CPI (Urban) have been derived from the results of the NSS 61st round of Consumer Expenditure Survey (2004–05).

For regular price collection, 310 towns have been selected, which include all State/UT capitals. From each selected town, price data are collected in respect of items consumed by the population of the respective State/UT. In all, 1114 price schedules containing an average of 250 items are canvassed every month. House rent data are also collected from a fixed set of rented dwellings from the selected towns. Prices of items are collected by the field officials of the National Sample Survey Office (NSSO).

New series of CPI for rural areas

CPI (Rural) numbers are compiled at state/UT and all-India levels. Weighting diagrams of the CPI (Rural) have also been derived from the results of the NSS 61st round of Consumer Expenditure Survey (2004–05).

With a view to have a workload within manageable limits and considering the fact that the CPI (Rural) would provide the price changes for the entire rural population of the country, a total of 1181 villages have been selected at all India level. The broad criterion of selection of villages is to have representation of all the districts within State/UT and two villages from each district have been selected randomly from different tehsils. However, to provide adequate representation of the total rural population in some States/UT, allocated number of villages to the states has been increased or

decreased on the basis of population of the concerned State/UT. Regular prices are collected by the officials of the Department of Posts. One schedule containing an average of 225 items from each selected village is canvassed for collection of prices every month.

National CPI

CSO will also compile national CPI by merging CPI (Rural) and CPI (Urban) with appropriate weights, as derived from NSS 61st round of Consumer Expenditure Survey (2004–05) data.

Weighting diagrams

The share (weight) of the Food, beverages and tobacco group in the all India CPI (Rural) is 59.31% and it is 37.15% in the all India CPI (Urban). Fuel and light group has a weight of 10.42% in CPI (Rural) and 8.40% in CPI (Urban). Clothing, bedding and footwear group has weight of 5.36% in CPI (Rural) and the weightage of 3.91% in CPI (Urban). Housing group has not been given any weightage in the rural areas. CPI as its share is around 1% and it has been distributed to other groups on pro rata basis. CPI (Urban) has a weightage of 22.53% in respect of Housing group. The Miscellaneous Group consisting of education, medical care, transport and communication etc has 24.91% weight in the all India CPI (Rural) and the corresponding weight in the all India CPI (Urban) is 28%.

Release of indices

Index numbers for both rural and urban areas and also combined for the month of January, 2011 was released on 18th February, 2011. It is proposed to release provisional indices for a period of one year. Indices for States/UT will be released only if adequate number of schedules is received at the time of compilation of index. These provisional numbers will be subsequently revised and final numbers with complete data for all-India and also for all the States/UTs would be released with a time lag of two months. It is expected that data reporting will be considerably improved and there may not be any need to bring out separate provisional numbers after December, 2011. Indices for January, 2012 onwards along with annual inflation rates are likely to be released with a time lag of one month.

Revision of Indices

These new CPI numbers would be revised on the basis of the results of the next round of Consumer Expenditure Survey scheduled to be conducted during 2011–12 by the NSSO. Thereafter, revision will be undertaken every five years or so (whenever large scale Consumer Expenditure Survey data become available).

Trends in Inflation

Inflation has been a highly sensitive issue in India right since the Independence and it has been so during the ongoing reforms process period, too. It has an incessant tendency of resulting into ‘double digits’, taking politically explosive proportions like governments falling at the Centre and state levels due to price rise of the commodities such as edible oil, onion, potato, etc. In such situations the

Government in general has been taking recourse to tighter money supply to contain the state level disturbances due to price rise of the commodities such as edible oil, onion, potato, etc. although it has contained inflation but at the cost of higher growth. Price rise got rooted in India's political psyche in such a way that the Government did check frequent famines quickly at the cost of long-term endemic hunger and sustained malnutrition.[44] The Government did not go to search the fine balance of the trade-off between inflation and growth due to political risk. The present period (2007–08) is almost similar to it when economy required higher money supply for investment but the Government's monetary policy proposes to contain inflation below 6 per cent with the help of tighter monetary policy.

Decadal inflation in India looks comparatively normal with reference to many developing economies.[45] But it has sporadic incidences of double-digit tendencies mainly due to supply-side shortfalls caused by droughts (monsoon failures), price rise of crude oil in the international market or fund diversions due to wars (the Chinese war of 1962 and the Pakistan wars of 1965–66 and 1971). The decadal inflation in India has been as given below:[46]

(i) *During 1950s:* remained at 1.7 per cent.

(ii) *During 1960s:* remained at 6.4 per cent.

(iii) *During 1970s:* remained at 9.0 per cent.

(iv) *During 1980s:* remained at 8.0 per cent.

(v) *During 1990s:* remained at 9.5 per cent (though it reached 0.5 per cent by the fourth quarter of the fiscal 1998–99)

(vi) *During 2000–01 to 2012–13:* remained at 4.7 per cent (upto August 2007) with the fiscal 2002–03 at 3.4 per cent (the lowest) and the fiscal 2004–05 at 6.5 per cent (the highest).But the years after 2008 has been tough on the front of inflation. Headline year-on-year WPI inflation after remaining persistently high in 2010, 2011 and 2012. Though it did show signs of moderation by late 2012, financial year 2012-13 started with an inflation of 7.5 per cent increasing to 8.07 per cent by **December 2012**. Some of the contributory factors[47] for the higher inflation during the period were:

  (a) Higher primary articles prices driven by vegetables, eggs, meat, and fish due to changing dietary pattern of consumers;

  (b) Increasing global commodity prices especially metal and chemicals;

  (c) High international prices of crude oil.

Economic Survey 2012-13 projects a moderate rate of inflation of 6-6.5 per cent during the fiscal 2013-14 with expected short-term shocks due to – inadequate food stocks, slippages in the targets of the fiscal consolidation, checking real estate bubbles, and energy prices.

The last time inflation went in double digits it was in the fiscal 1991–92 when it was at 13.6 per cent by 1997–98, though it moderated to the level of 3.5 per cent later.[48]

An analysis of inflationary trends in India does not pin-point any one reason behind it. The economists have pointed out all possible reasons (the so-called ***'good'*** and ***'bad'***) behind the inflationary pressures in the economy of which we may have a brief review:

1. Structural Inflation

With few exceptional years, India has been facing the typical problem of bottleneck inflation (***i.e structural inflation***) which arises out of shortfalls in the supply of goods, a general crisis of a developing economy, rising demand but lack of investible capital to produce the required level of goods.[49] Whenever the Government managed to go for higher growths by managing higher investible capital it had inflationary pressures on the economy (seen during 1970s and 1980s, specially) and growth was sacrificed at the altar of lower inflation (which was politically more justified)[50]. Thus the supply-side mismatch remained a long-drawn problem in India for higher inflation. After some time even if the government managed higher expenditure, most of it was eaten by the non-developmental areas which did show low growth with higher inflation signs of a stagnating economy.

2. Cost-Push Inflation

Due to 'inflation tax' the price of goods and services in India have been rising as the Government took alternative recourse to increase its revenue receipts.[51] We see it taking place due to higher ***import duties*** on the raw materials also.[52] The ***non-value-added*** (non-VAT) tax structure of India in the past was also having cascading effect on the prices of commodities in the country.[53] The Government needed higher revenues to finance its planned development thus the above given factors looked inescapable!

3. Fiscal Policy

To finance the developmental requirements of the economy, the Governments became trapped in the cyclical process of over-money supply. At first it was done by external borrowings but by the late 1960s onwards (once ***deficit financing*** got acceptance around the world) the governments started taking recourse to heavy internal borrowings as well as printing of fresh currency too. A major part of the government's internal borrowing is contributed by the Reserve Bank of India (RBI) which leads to price rise.[54] For any government deficit if the Central Bank (RBI) is purchasing primary issues of the Government securities or creating fresh advances to the government the combined effect has to be higher inflation, lower savings rates and lower economic growth[55a] —the vices of unsound fiscal policy. The higher fiscal deficit tends to bring about higher interest rates as demand for funds rise, excess demand raises expected inflation and expected depreciation of the currency[55b]. Once the foreign exchange (Forex) reserves started increasing with a faster pace by the early 2000–01 fiscal, its cost of maintenance has been translated into higher prices, as the RBI purchases the foreign currencies it supplies into equivalent rupees into the economy which creates extra demand and the prices go up.[56]

New series of CPI— All India weights

Sub group/group	*Rural*	*Urban*	*Combined (Rural+Urban)*
Cereals and products	19.08	8.73	14.59
Pulses and products	3.25	1.87	2.65
Oils and fats	4.67	2.89	3.90

Egg, fish and meat	3.38	2.26	2.89
Vegetables	6.57	3.96	5.44
Fruits	1.90	1.88	1.89
Sugar etc	2.41	1.26	1.91
Condiments and spices	2.13	1.16	1.71
Non-alcoholic beverages	2.04	2.02	2.03
Prepared meals etc	2.57	3.17	2.83
Pan, tobacco and intoxicants	2.73	1.35	2.13
Food, beverages and tobacco	**59.31**	**37.15**	**49.71**
Fuel and light	**10.42**	**8.40**	**9.49**
Clothing and bedding	4.60	3.34	4.05
Footwear	0.77	0.57	0.68
Clothing, bedding and footwear	**5.36**	**3.91**	**4.73**
Housing		**22.53**	**9.77**
Education	2.71	4.18	3.35
Medical care	6.72	4.34	5.69
Recreation and amusement	1.00	1.99	1.43
Transport and communication	5.83	9.84	7.57
Personal care and effects	3.05	2.74	2.92
Household requisites	4.48	3.92	4.30
Others	1.12	0.99	1.06
Miscellaneous	**24.91**	**28.00**	**26.31**
All Groups	**100.00**	**100.00**	**100.00**

The higher revenue deficits (driven by high interest payments, subsidies, salaries and pensions, basically) and fiscal deficits make the government supply more money which push the inflation in the upward direction. Once the Fiscal and Budget Management Act came into force in 2003, the scenario improved in the coming times. Though the period from 1999 to 2003 did show high growth with low inflation and the lowest interest rates in India.

PROTEIN INFLATION

Some recent articles suggest that a change in dietary habits towards protein-rich foods has been a key driver of high food price inflation in India *(Subbarao 2011, Gokarn, 2011);* they also suggest that this is a result of:

(a) rising nominal rural wages helped by the expansion of the Mahatma Gandhi National Rural Employment Guarantee (MGNREGA) scheme;

(b) inadequate producer supply responses relative to demand; and

(c) shocks from global food inflation, as India integrates with the world. A more nuanced view is possible on each factor.

Protein inflation: rising prices of pulses, fish, meats, eggs, and milk is evident (figure above). But the causes are more complicated than rising spending among low-income rural households. First, the shift to more expensive proteins is very unlikely to be from rising incomes in rural areas from income groups benefited by the MGNREGA. Incomes of average rural households in the bottom two deciles (MGNREGA target beneficiaries), for example, would have to jump to those of the rich farmer category, the sixth decile in rural areas, for a modest Rs. 100 monthly increase in per capita spending on protein-rich items by those households. The average (5th decile) urban household, by contrast, spends as much as seven times more than the bottom rural decile on protein-rich foods, and could achieve the same increase with a much more modest increase in incomes. Fast-growing urban consumers benefiting, for example, from the government's sixth pay commission pay hikes in 2008-9 and even larger private-sector salary hikes after a spectacular urban growth spurt during 2004-8, are a far more likely source of rising demand. Consider milk consumption. Monthly per capita liquid milk consumption in urban areas (from National Sample Survey [NSS] data) is far higher (5.4 litres) than in rural areas (4 litres); milk products (powder, solids, paneer, cheese, others) consumption is overwhelming and fastest growing (over 12 per cent per annum) in urban areas worldwide. Whereas, much of rural consumption is in own use, non-market forms that only affect market prices from a distance.

Second, we turn our attention to supply-demand imbalances. Milk happens to have the biggest weight (52 per cent) in consumption expenditures on protein-rich items in India and a closer look is useful. It turns out that inability to produce Milk is not necessarily the problem. India is the world's largest milk producer, milk production has been growing by over 4 per cent per annum, twice as fast as general agriculture and world production, and as rapidly as rising demand, raising per capita consumption successfully from 217 g to 263 g per day during 2000-10. Exports of milk products are also growing. Thanks to the 'white' revolution, the sector is relatively better organised, a success story worldwide, by helping smallholders into cooperatives and arranging an efficient collection, storage, and distribution system. Less well-developed but similar systems also operate in egg, poultry, and fisheries, whose production has also grown apace. Despite weaker and more volatile production, pulses, the poor-man's protein, have seen a lower price rise.

Two things stand out regarding Indian milk prices.

1. Global milk prices have surged, helping Indian milk prices rise higher; the decline of the EU's milk surplus has been a key factor, as important as rising appetites among richer urban classes in emerging markets;
2. Indian milk prices have, however, grown even faster, doubling from US$200 a tonne in 2002 to well over US$400, catching up with the USA, the world's richest milk producer, and matching New Zealand. Notice also the smoother price rise in India, which is characteristic of more 'organised' market processes. Such higher prices are expected to lead to rapid reduction response, although rising feed costs (fodder) for smallholders are a major factor in a land-scarce country.

[**Sources : (1)** FAO Food Stats and Country Data; **(2)** Duvvuri Subbarao, 2011. The Challenge of Food Inflation, Presidential Address, Annual Conference of the Indian Society of Agricultural Marketing, Hyderabad, 22 November. **(3)** Subir Gokarn, 2011. Kale Memorial Lecture, Gokhale Institute of Politics and Economics, Pune, 9 December. **(4)** Dipak Dasgupta et al., 2011. Domestic

Wheat Price Formation and Food Price Inflation in India, Ministry of Finance Working Paper. **(5)** Nancy Morgan, 2009. Dairy Prices, Policies and Potential Opportunities for Smallholders in Asia, Asia-Pacific Dairy Strategy project. **(6)** Wayne Arnold, 2007. A Thirst for Milk Bred by New Wealth Sends Prices Soaring, New York Times, September 4. **(7)** Jesper Stage, Jorn Stage, and Gordon McGranahan, 2009. Is Urbanization Contributing to Higher Food Prices? UNFPA. **(8)** Milk Prices up 35%, CCI targets 'cartel'. The Financial Express, 2011. **(9)** Shalini Gupta, Food Expenditure and Intake in the NSS 66th Round, Economic and Political Weekly, 14 January, 2012, Vol. XLVII, No. 2.]

[as quoted by the *Economic Survey 2011-12*, op. cit., p. 81-82]

WHY HAS INFLATION PERSISTED?

As per the *Economic Survey 2012-13*, inflation in protein foods, particularly eggs, meat and fish, and in fruits & vegetables has persisted because of *changes in dietary habits* and *supply constraints*:

- Long time series data from National Accounts on *PFCE* (private final consumption expenditure) indicate a structural shift in per capita consumption. The share of food consumption in total consumption has declined over time, from an average of 51.34 per cent during 1950-60 to an average of 27.17 per cent during 2007-2012.
- Average annual growth in per capita food consumption at 0.94 per cent during 1950-2012 has been significantly lower than the overall growth in consumption averaging 1.84 per cent. The consumption of protein foods, though increasing more slowly than the increase in PFCE, had a growth of 1.50 per cent during 1950-2012, higher than the growth of overall expenditure on food. Therefore, the share of protein foods within overall food expenditure increased from 26.28 per cent during 1950-60 to 33.71 per cent during 2007-2012.
- A secular decline in expenditure on food relative to that in other commodities and services as expected has been associated with rising income levels.
- Average annual growth of per capita expenditure during 1950-2011 was 2.40 per cent for non-food group. Within non-food commodities and services, average annual growth was 5.53 per cent, 3.97 per cent, 3.60 per cent and 3.42 per cent for transport and communication; recreation and education; medical and health care; and miscellaneous goods and services, respectively. Growth in expenditure for these sub sectors significantly exceeded the growth in expenditure on food. *Post reform* period (1992-93 to 2010-11) has shown a faster shift in consumption expenditure.
- An *increase in income* made this desirable shift in consumption feasible. At national level, per capita income, adjusted for inflation continued to rise.
- There was also a significant increase in rural wages. Rural wages in nominal terms went up by an average of over 18 per cent from 2008-09. Inflation-adjusted rural wages also went up by 7.5 per cent during this period.
- The ***input costs*** for producers in both the food and non-food segments, as reflected in the prices of feed, fodder and other inputs also increased. An increase in Minimum Support Price (MSP), while necessary to ensure remunerative returns to farmers, raised the floor prices and also contributed to the rise in input prices.

Healthy Range of Inflation

Higher inflation and higher growth as a trade-off was questioned in the late-1980s by the developed economies as the economic and social costs of higher inflation also needed policy attention—a costly 'trade-off'.[57] In coming times, most of the world economies went in favour of a stable inflation (i.e. ***inflation targeting***) though the idea has been ***protested***[58]. India also started inflation targeting by the early 1970s. It was in 1973 that the inflation crossed 20 per cent mark on account of the international oil price rise and the Government (the Indira Gandhi Government) devised a severe anti-inflation package which included directly restricting the disposable incomes of the people (this measure was used for the *first* time in India[59]). The package had an impact and by March 1975 the inflation calmed down to 5.7 per cent. This was the time when the RBI was given a new function 'inflation stabilization' and India entered the era of monetary controls for inflation. With inflation targeting there started a debate concerning the healthy range of inflation for the Indian economy i.e. by mid-1970s. We may have some official and non-official versions of the suitable range of inflation pointed out from time to time:

(i) The ***Chakravarty Committee (1985)*** treated 4 per cent inflation acceptable for the economy in its report on the monetary system. He also added that this level of price rise will facilitate the purpose of attracting investment for the desired level of growth.

(ii) The ***Government of India*** accepted a 4 to 6 per cent range of inflation as acceptable for the economy citing the world average of 0 to 3 per cent at the time (1997–98).[60]

(iii) The RBI Governor ***C. Rangarajan*** advocated that the inflation rate must come down initially to 6 to 7 per cent and eventually to 5 to 6 per cent on an average over the years.[61]

(iv) The ***Tarapore Committee*** on Capital Account Convertibility recommended an acceptable range of 3 to 5 per cent inflation for the three year period (1997–98 to 1999–2000).[62]

In the recent times (June 2003 onwards) the Government/the RBI has maintained a general policy of keeping inflation below 5 per cent mark—at any cost—as if fixing 4 to 5 per cent as the healthy range of inflation for the economy.[63]

The medium-term objective (i.e. target) of the Government is to keep inflation in the 4–4.5 per cent range.[64] One thing should be kept in mind that inflation has always been a political matter in the country. Every time the RBI tried to check the rising inflation via monetary measures a majority of experts objected to it by calling it a move to sacrifice growth for lower price levels. A tighter monetary policy decelerates investment and growth, hampers the growth prospects of the middle class in general and the entrepreneurs in particular while the wage-earners as well as the poor segment of society feels relieved (at least in short term).

GOVERNMENT/RBI STEPS TO CHECK INFLATION (2012-13)

Rising prices remained in news through out this financial year, too. In recent times, the GoI/RBI took the following steps to check the inflation from rising *(Economic Survey 2012-13, p.93)* –

1. Fiscal Measures

i. Import duties for wheat, onions, pulses, and crude palmolein were reduced to zero and 7.5 per cent for refined vegetable & hydrogenated oils.
ii. Duty-free import of white/raw sugar was extended up to 30 June 2012; presently the import duty has been fixed at 10 per cent.

2. Administrative Measures

i. Ban on exports of onions was imposed for short periods of time whenever required. Exports of onions were calibrated through the mechanism of minimum export prices (MEP).
ii. Futures trading in rice, *urad, tur,* guar gum and guar seed was suspended.
iii. Exports of edible oils (except coconut oil and forest-based oil) and edible oils in blended consumer packs up to 5 kg with a capacity of 20,000 tons per annum and pulses (except *Kabuli chana* and organic pulses and lentils up to a maximum of 10,000 tonnes per annum) were banned.
iv. Stock limits were imposed from time to time in the case of select essential commodities such as pulses, edible oil, and edible oilseeds and in respect of paddy and rice up to 30 November 2013.

3. Measures to Insulate the Vulnerable Sections

i. The central issue prices (CIP) for rice (at Rs 5.65 per kg for below poverty line [BPL] and Rs 3 per kg for Antodaya Anna Yojana [AAY] families) and wheat (at Rs 4.15 per kg for BPL and Rs 2 per kg for AAY families) have been maintained since 2002.
ii. Under the targeted PDS (TPDS) allocation of foodgrains is being made to 6.52 crore AAY and BPL families at 35 kg per family per month at a highly CIP.
iii. The government has allocated rice and wheat under the Open Market Sales Scheme (OMSS).
iv. The scheme for imports of pulses which envisaged imports for distribution to BPL households through the PDS with a subsidy of Rs 10 per kg operated from November 2008 to June 2012. The government has decided to implement a varied form with a subsidy element of Rs 20 per kg per month for BPL cardholders for the residual part of the current year. The targeted BPL cardholders will be as estimated by the Department of Food and Public Distribution.
v. The Scheme for Distribution of Subsidized Imported Edible Oils has been implemented since 2008-9 through state/union territory (UT) governments for distribution of 1 litre per ration card per month with a central subsidy of Rs 15 per kg. The scheme has been extended up to 30 September 2013.

4. Budgetary and other Measures

i. A number of measures were announced in Union Budget 2012-13 to augment supply and improve storage and warehousing facilities. The government launched a National Mission for Protein supplements in 2011-12 with an allocation of Rs 300 crore. To broaden the scope of

production of fish to coastal aquaculture, apart from fresh water aquaculture, the outlay in 2012-13 was stepped up to Rs 500 crore. Recently the government permitted FDI in multibrand retail trading. This will help consumers and farmers as it will improve the selling and purchasing facilities.

5. Monetary Measures

i. The RBI had also taken suitable steps to contain inflation with 13 consecutive increases by 375 basis points (bps) in policy rates from March 2010 to October 2011.

IMG ON INFLATION

An Inter-Ministerial Group (IMG) on inflation was set up on 2 February, 2011, on the recommendation of the Prime Minister, under the Chairmanship of Chief Economic Adviser, Ministry of Finance to review the overall inflation situation, *with particular reference* to primary food articles. Upto February 2013, the IMG had eight meetings covering various aspects, including information system on all aspects of price monitoring, Foreign Direct Investment (FDI) in *multi-brand retail*, reform in APMC Act, policy options for *diesel pricing* and inflation in *protein rich* products among others.

In the sixth and seventh meetings the IMG had discussed policy options to reduce the *distortions* in the prices between diesel and other petroleum product. It was suggested that in a gradual manner subsidy on diesel may be shifted to fixed per litre basis and price adjustment could be more frequent, and with regular intervals, may be on a monthly basis. It was also mentioned that any revision in diesel prices would have a direct and indirect impact on inflation, which continues to be at elevated levels. The revision, therefore, needs to be calibrated.

IMG further recommended a long term credible policy intervention for augmenting supplies of primary products. MSP based incentives without a breakthrough in productivity level, may not be sufficient. Productivity of pulses could be increased with the use of genetic seeds and a proper regulatory environment.

Producer Price Index

A working Group was set up in mid-2003–04 under the chairmanship of Prof. Abhijit Sen, Member, Planning Commission to fulfill the twin tasks of:

I. revising the current series of the WPI (i.e. base 1993–94) and
II. recommending a producer price index (PPI) for India which could replace the WPI.

The sub-groups of the working group have submitted their reports and the procees of revision in the base year for WPI is at the final stage. The new series (***base year***) for the WPI is decided to be the fiscal prices of 2000–01.

The proposal of switching over to the PPI (from the WPI) came up from the Government by mid-2003 and the working Group has been getting inputs from the IMF regarding it. The PPI measures price changes from the perspective of the producer while the cosumer price index (CPI) measures it from

the consumers' perspective. As the producers sell at higher prices to their wholesellers, so retailers and the price increase is translated into the higher consumer prices—thus the PPI is useful in having an idea of the consumer prices in the future.[65] In PPI, only basic prices are used while taxes, trade margins and transport costs are excluded. This index is considered a better measure of inflation as price changes at primary and intermediate stages can be tracked before it gets built into the finished goods stage.[66] Due to its better use many economies have switched over to the PPI—the oldest such series is maintained by the Bureau of Labor Statistics (BLS) for the US economy—the index is capable of measuring prices at the wholesaler or the producer stage—widely used by private business houses in their price targetting.[67]

Once India shifts from the WPI to the upcoming PPI, the economy is supposed to have a better idea of the trends inflation.

Housing Price Index

India's official Housing Price Index (HPI) was launched by the Finance Minister on July 9, 2007 in Mumbai. Basically developed by the Indian home loans regulator, the National Housing Bank (NHB) the index is named ***NHB Residex***. Presently, the index has been introduced as a pilot project for five cities—Bangalore, Bhopal, Delhi, Kolkata and Mumbai which covers different localities in each of these cities for the five-year period (2001–05).

There are various concepts of housing price indices, and many sources and ways for compiling price data—both private and public. The methodology of constructing such indices varies from country to country depending upon the use and purpose as well as the data availability. A Technical Advisory Group (TAG) was set up under the chairmanship of an adviser from the Ministry of Finance in 2006–07 which had members and experts from public and private bodies of the concerned field i.e. NHB, CSO, RBI, HDFC, HUDCD, LIC Housing Finance Ltd., Labour Bureau, Dewan Housing Finance Corporation Ltd., and the Society for Development Studies (SDS). After reviewing international best practices and the methodology, sampling techniques, collection of price data for construction of real estate price indices in the USA (index developed by the office of Federal Housing Enterprise Dversight), Canada (New Housing price Index) and the UK (Halifax Index), the TAG suggested a proper methodology for India. The TAG has conducted a pilot study for Delhi in which both the models of index-making were used.[68] They were -

(i) hedonic regression model, and
(ii) the basic Laspeyre's weighted index.

It is well-known that the registered price of houses are grossly under-estimated due to very high registration fees and stamp duty. The subsequent obligations for the payment of property tax acts as a dis-incentive to individual purchases (except the corporate bodies) for revealing the exact purchase price of a house. That is why, in addition to information from registration offices, basic data on value, plinth area, location, age and basic characteristics of the houses were collected from property dealers, Resident's welfare Associations (RWAs), Development Authorities/Municipal Corporations and the private builders.

The TAG decided to take 2001 as the ***base year*** for the index which is consistent with the base period of the other indices i.e. 2001 for the revised CPI (IW), 2000–01 for the revised WPI and 1999–2000

for the revised GDP series.

With an overall objective of bringing transparency in the Indian real estate market, the index is expected to serve some highly important and timely purposes:

(a) Whether a broker is quoting too high a price for houses in the cities.

(b) Banks/housing finance bodies will be able to estimate only if the loan applications are realistic for the properties.

(c) This will also show the level of non-performing assets in the housing sector.

(d) And most importantly it will serve as a realistic price index for the buyers. (At present a buyer has no means, to judge whether a rise in property price was in the offing with the general level of inflation (i.e. at WPI) in the country, or has been scaled up disproportionately. Other than quotes from brokers, there are no means at present to evaluate the changes in price in this sector. At present the only index that gave some idea of housing price changes was the CPI (IW) which being a national index did not show the ***regional variations***.)

In the next phase, the NHB will compile indices for 35 cities/towns with a population of more than a million (as per the census 2001). These indices are planned to be prepared on a half-yearly basis, to be subsequently expanded to cover 63 cities/towns covered under the Jawaharlal Nehru National Urban Renewal Mission (JNNURM).

Service Price Index

The contribution of the tertiary sector in India's GDP has been strengthening for the past 6 to 7 years and today it stands approximately at 54 per cent. The need for a service price index (SPI) in India is warranted by the growing dominance of the sector in the economy.[69] There is no index, so far, to measure the price changes in the service sector. The present inflation (at the WPI) only shows the price movements of the commodity-producing sector i.e. it includes only the primary and the secondary sectors—the tertiary sector is not represented by it.

The need for such an index was recommended by the working Group (under the Chairmanship of Prof. Abhijit Sen, Member, P.C.) set up to revise the WPI (1993–94) series which was reiterated by the National Statistical Commission (headed by C. Rangarajan).The office of the Economic Adviser, Ministry of Commerce and Industry has been making an effort to develop sector-specific service price index for the country with the technical assistance being received under the World Bank Assisted Economic Reforms Projects (WBAERPs).At present, efforts are being made to develop service price indices for selected services initially on an experimental basis (covering road transport, railways, airways, business, trade, port, postal telecommunications, banking and insurance services only).

The basic studies of index construction are complete. Before formal launching of the index, the complete study is supposed to be discussed with academicians, practitioners and the users of the services. The need to construct a service price index for the economy was felt more after the *OECD-Eurosat Report of 2005* on the subject.[70]

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33. Samuelson & Nordhaus, op. cit., p. 723.
34. New Zealand passed a law to do this with a target of 0 to 2 per cent inflation with a provision that the Reserve Bank of New Zealand governor could be fired if inflation crossed the 2 per cent upper limit—now this target range has been revised to 1 to 3 per cent (as write Stiglitz & Walsh, op. cit. p. 849).
35. Samuelson & Nordhaus, op. cit., p. 674.
36. Samuelson & Nordhaus, op. cit., p. 674.
37. ***Economic Survey, 2006–07,*** MoF, GoI, p. 85
38. The three major classifications of the items in the WPI were followed for the first time when India went for the third revision of the prices with 1970–71 as the base year which was introduced in January 1977. The same classification is followed till date with changes in the assignments of weights to the items (***Economic Survey*** 2006–07, op. cit, p. 85).

39. The economies of the Euro-American region have a single CPI as the majority of consumers show the same consumer behaviour (see Rosser and Rosser, ***Comparative Economics in a Transforming World Economy,*** Prentice-Hall, MIT Press, Cambridge, USA, 2004).
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61. Rangarajan, C., 1998, op. cit., pp. xii & 61–63.
62. We may refer to almost all the Credit and Monetary Policies announced by the RBI during this period.
63. As the RBI put it in its Credit and Monetary Policy Review of July 31, 2007.
64. It should be noted here that the level of inflation was below 5 per cent till the new Government came to power and the outgoing Government was blamed to freeze the inflation data to a more politically digestable level (i.e., below 5 per cent). The new Government in the process of preparing a producer price index (PPI) has also committed to make the inflation data automated like the shave indices.
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66. ***Economic Survey 2006–07,*** op. cit., p. 92.
67. Samuelson and Nordhaus, op. cit., p. 441.
68. ***Economic Survey 2006–07,*** op. cit., p. 92.
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70. 'The number of National Statistical Agencies collecting service producer prices data, though growing, is still small', points out the ***OECO-Eurosat, 2005 Inquiry on National Collection of Services Producer Prices Preliminary Report,*** giving information

on 45 such countries. The report further adds that while some such agencies have focused exclusively on the price of services provided to enterprises, others have approached the subject more broadly through the development of services producer price indices with varying approaches and coverage. As per the report, at present, 30 countries collect services producer prices while prelimilary works have started in the other countries, particularly the European countries under the auspices of the Eurosat. Other than the developed Euro-American economies some other countries which worked as inspiration for India which have such an index are China, Hong Kong, Czech Republic, Slovak Republic, Poland, Lithuania, Israel and Vietnam.

SECTION-B

BUSINESS CYCLE

INTRODUCTION

The discussion on growth and development has shown their internal interdependence. If the quality of life in an economy is to be enhanced, there is a need of conscious public policy which can spend and invest in areas like food, nutrition, health, education, shelter, social security, etc. But for such expenditures and investments, the economy needs equitable level of income, too! The income enhancement in any economy takes place via increasing the level of production in the economy i.e. real gross national product (GNP). It means, development requires higher growth i.e. higher levels of economic activities. With the help of suitable kind of economic policies, the government of an economy keeps trying to maintain a higher level of economic activity. But, at times, economy keeps failing in this objective. And, thus economies fluctuate between the best and the worst levels of economic activities which is known in economics as ***boom*** and ***depression***, respectively. They can be called different phases of the economic activities of the economies. In between boom and depression, there might be many other situations of the economic activities, such as—***stagnation***, ***slowdown***, ***recession*** and ***recovery***. The fluctuations in the level of economic activity between the depressions and booms has been called by the economists as ***business cycle*** or ***trade cycle*** with recession and recovery as the main intermediate stages[71]. Stagnation[72] and slowdown may be considered as other intermediate stages of the business cycle. We intend here to understand the actual meanings of each of the stages. The economists have pointed out that the business cycle is characterised by ***four*** phases or ***stages*** in which economies alternate:

i. Depression
ii. Recovery
iii. Boom
iv. Recession

DEPRESSION

Though depression has visited the world economy only once in 1929, economists have pin-pointed enough number of traits to recognise it. The ***major*** traits of depression could be as given below:

(a) an extremely low aggregate demand in the economy causes activities to decelerate;
(b) the inflation being comparatively lower;
(c) the employment avenues start shrinking forcing unemployment rate to grow fast;
(d) to keep the business going, production houses go for ***forced labour-cuts*** or ***retrenchment*** (***to***

cut down the production cost and be competitive in the market) etc.

The economic situations become so chaotic in the phase of depression that the governments have almost no control over the economy. The Great Depression of 1929[73] gave rise to the ideas of ***strong government intervention***[74] in the economy, such as deficit financing, monetary management, etc.

What the governments may do if depression visits the economy? The simple answer the world has been able to find is to repeat the policy measures of 1929! The best way to avoid depression is not to let it visit. This is why every modern economy keeps extra-vigil on the major symptoms of its economy so that the prevention-measures can be taken in time and depression is avoided.

RECOVERY

An economy tries to come out of low production phase to survive. The low production phase might be depression, recession or slowdown with the former being the worst and rare, governments take many new fiscal and monetary measures to boost demand and production and ultimately a recovery in an economy is managed. The business cycle of recovery may show the following ***major*** economy traits:

(a) an upturn in aggregate (total) demand which has to be accompanied by increase in the level of production;

(b) production process expands and new investments become fattractive;

(c) as demand goes upward, inflation also moves upward making borrowing cheaper for investors;

(d) with an upturn in production, new employment avenues are created and unemployment rate starts declining; etc.

With the above symptoms, people's income go for a certain increase which creates new demand and a cycle of demand and production (supply) starts playing hand-in-hand to recover the economy. To recover an economy, governments usually go for tax-breaks, interest cuts, an increase in salaries of its employees, etc. Assimilation of innovations by the entrepreneurs and search for new frontiers of enterprise do play a very vital role in the process of recovery provided these activities are at first incentives by the governments.

The Euro-American economies recovered out of the Great Depression with the help of the measures cited above. Such recoveries have been seen many times around the world when economies recovered from slowdown or the recessionary phases. The best example of the recent times could be cited from India of 1997 to 2002 when the economy suffered severe bouts of slowdown and recession.[75]

BOOM

A strong upward fluctuation in the economic activities is called boom.[76] As economies try to recover out of the phases of slowdown, recession and depression at times the measures taken by the governments as well as the private sector might put the economic activities as such which the

economic systems fail to digest. This is the phase of the ***boom.*** The ***major*** economic traits of boom may be listed as given below:

(a) an accelerated and prolonged increase in the demand;

(b) demand peaks up to such a high level that it exceeds sustainable output/production levels;

(c) the economy heats up and a demand-supply lag is visible;

(d) the market forces mismatch (***i.e. demand and supply disequilibirium***) and tend to create a situation where inflation start going upward;

(e) the economy might face structural problems like shortage of investible capital, lower savings, falling standard of living, creation of a sellers' market.

The phase of recovery is considered good for the economy and it reaches the stage of boom which is considered better. But the boom has its negative side also. Boom is usually followed by price rise.[77] As a boom is a strong upward fluctuation in an economy, the supply-side pattern of the economy starts lagging behind the pace of the accelerated aggregate demand.[78] But the dilemma of recovery puts every economy on the path to boom—this has been the experience in the developed world during the 1990s, especially in the US economy. The same scenario developed in India after the economy recovered from the recessionary period of 1996–97 by the year 2002–03 when the rate of inflation peaked to almost 8 per cent for a few months. Majority of the experts felt that Indian economy at that time was passing through a phase of boom and we have seen how the government has been facing difficulty in containing the inflation around the 5 per cent mark. Even the Government accepted that the economy was over-heating by mid-2007. *The symptoms of overheating are as follows:*[79]

(a) There is a downturn in the aggregate demand on overall fall in the demand;

(b) as demand falls, the level of production (output) in the economy also falls;

(c) as producers cut down their production levels, new employment opportunities are not created —thus employment growth rate falls;

(d) as demand keeps on falling, usually producers start cutting down their labour force to adjust their overhead expenditure and the cost of production (labour-cut is not 'forced' here but, 'voluntary')—resulting in increase in the unemployment rate;

(e) if the government fails to rescue the economy from the phase of recession, the dangerous stage of ***depression*** remains the logical follow up;

(f) the rate of inflation always remains at lower levels—discouraging new investments and lending.

RECESSION

This is somewhat similar to the phase of 'depression' – we may call it a *mild form* of depression – fatal for economies as this may lead to depression if not handled with care and in time. The financial crises which followed the US 'sub-prime crisis' in almost the whole Euro-American economies has basically brought in a'severe recessionary' trends there. Major traits of recession, to a great extent, are similar to that of 'depression' [except the point (d) of the Depression, discussed earlier] – may be summed up as follows –

(a) there is a general fall in demand as economic activities takes a downturn;
(b) inflation remains lower or/and shows further signs of falling down;
(c) emloyment rate falls/unemployment rate grows;
(d) Industries resort to 'price cuts' to sustain their business.

In the financial year 1996–97, the Indian economy was taken up by the cycle of recession—basically due to a general downturn in domestic as well as foreign demands, initiated by the South East Asian Currency Crisis of mid-1990s.[80] The whole plan of economic reforms in India was derailed and it was only by the end of 2001–02 that the economy was able to recover. What may a government do to rescue the economy from the phase of recession? The usual remedies are given below:

(i) Direct and indirect taxes should be cut down, so that the consumers have higher disposable incomes (income after paying direct tax i.e. income tax) on the one hand and the goods should become cheaper on the other hand thus there is hope that the demand might pick up.
(ii) The burden of direct tax, specially the income tax, divdend tax, interest tax are slashed to enhance the disposable income (***i.e income after direct tax payment***)—
(iii) Salaries and wages should be revised by the government to encourage general spending by the consumers (as the Government of India implemented the recommendations of the fifth pay commission without much deliberation in 1996–97).
(iv) Indirect taxes such as custom duty, excise duty (cenvat), sales tax, etc. should be cut down so that produced goods reach the market at cheaper prices.
(v) The government usually goes on to follow a cheap money supply policy by slashing down the interest rates across the board and the lending procedure is also liberalised.
(vi) Tax breaks are announced for new investments in the productive areas. etc.

All the above-given measures were taken up by the United Front Government in 1996–97 to pull the economy out of the menace of recession.[81] The forthcoming Government took several other such measures by the end of 1998–99 onwards (the NDA Government). Ultimately, the measures taken up by the Governments acompanied by a general recovery in the world economy, the Indian economy started recovering recovery from the bout of recession. Many experts had already predicted a possibility of depression with a zero per cent rate of inflation.[82] Although this did not happen[83].

GROWTH RECESSION

An expression coined by economists to describe an economy that is growing at such a slow pace that more jobs are being lost than are being added. The lack of job creation makes it "feel" as if the economy is in a recession, even though the economy is still advancing. Many economists believe that between 2002 and 2003, the United States' economy was in a growth recession. In fact, at several points over the past 25 years the U.S. economy is said to have experienced a growth recession. That is, in spite of gains in real GDP, job growth was either non-existent or was being destroyed at a faster rate than new jobs were being added.

Experts have revived this term in the wake of ongoing financial cises in the Euro-American economies since 2010. The situation is better described by the term ***'double-dip recession'.***

CONCLUSION

Business cycles are basically fluctuations in the production levels of economies above and below the trend of the equilibirium levels.[84] But why do economies fluctuate? There are many factors which are said to be responsible for it, as per the experts:

(i) Economic instability and uncertainty (due to logical or illogical expectations) may discourage investments thereby reducing growth in the long-term.

(ii) A lack of the creative destruction (i.e. innovation) may put the economy in a slump or slowdown in its overall production.

(iii) Anti-inflationary government policies (specially when general elections are nearing) may direct the attraction of investors in the economy.

(iv) Unforseen disasters may cause economies to fluctuate.

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71. *Collins internet-linked Dictionary of Economics*, Glasgow, 2006 & Oxford Business Dictionary, N. Delhi, 2004.
72. Cox, Simon ed. *Economics*, The Economist, London; 2007, p. 60.
73. A very lively description of the Great Depression has been presented by ***Lee Iacocca*** in his autobiography. This is known as the Great Depression due to its length and depth—the economies could recover fully out of it only by the mid-1940s (*Stiglitz & Walsh, op.cit*; p. 495).
74. Suggested by John Meynard Keynes in his seminal work ***The General Theory of Employment, Interest and Money*** (Harcourt, New York, first published in 1935).
75. ***Economic Surveys, 1996–97 to 2002–03***, MoF, GoI, N. Delhi.
76. Stiglitz & Walsh, op. cit., p. 945.
77. Samuelson and Nordhaus, op.cit. pp. 680–84.
78. Stiglitz and Walsh, op.cit. pp. 495–796.
79. Ibid., p. 495.
80. ***Economic Survey, 1996–97,*** MoF, GoI, N. Delhi.
81. ***Economic Survey, 1996–97***, MoF, GoI, N. Delhi.
82. It should be noted here that as an impact of recession the rate of inflation (at WPI) had been falling down throughout the mid 1998–99 fiscal finally to the level of 0.5 per cent for a fortnight (***Economic Survey, 1998–99***, GoI, N. Delhi).
83. The literature of Economics and the empirical world experiences suggest that the phase of recession has all the symptoms of depression except one. Every thing being the same till producers are cutting the labour by force ‘involuntarily (i.e. ***forced labour cut***) it is the starting of depression—to be competitive in the market every producer starts ‘forced labour cuts’—ultimately putting the economy into the grip of a full grown depression.
84. Cox, Simon, op. cit., p. 58.

8

INDIAN AGRICULTURE

*Between 2000 and 2010, the contribution of cereals and pulses in the overall per capita food expenditure reduced from 40 per cent to 28 per cent, while that of animal-based products and fruits and vegetables rose from 36 per cent to 42 per cent – this change in consumption pattern has improved productivity of Indian farmers as well and studies show agricultural output per worker increased two times between 2000 and 2010. Barring this small tract, however, India's agriculture presents a dismal scenario with stagnating yield and low farmers income.**

- Introduction
- Kharif & Rabi
- Food Philosophy of India
- Land Reforms
- Green Revolution
- Minimum Support prices (MSP)
- Procurement Prices
- Issue Price
- Buffer Stock
- Economic Cost of Foodgrains
- Decentralised Procurement Scheme
- Rising Food Subsidy
- National Food Security Bill
- Sugar Sector Reforms
- Edible Oil Economy
- Agricultural Marketing
- e-choupal

** See Third Food and Agriculture Integrated Development Action Report titled 'India as an Agriculture and High-value Food Powerhouse: A New Vision for 2030', prepared jointly by CII and McKinsey & Company, N Delhi, Released on 12th April 2013.*

- Trifed
- Nafed
- Storing facilities for Agriculture Products
- Agricultural Credit
- Commodity Futures Market
- Farm Waste Debate
- Irrigation
- National Food Security Mission (NFSM)
- Macro Management of Agriculture (MMA)
- Rashtriya Krishi Vikas Yojana (RKVY)
- ISOPOM
- National Horticulture Mission (NHM)
- National Bamboo Mission (NBM)
- National Agricultural Policy, 2000
- Agricultural Insurance
- Extension Services
- National Mission for Sustainable Agriculture (NMSA)
- Second Green Revoution
- WTO and the Indian Agriculture: Prospects and Challenges
- The Prospects
- WTO and Agricultural Subsidies
- Economic Survey 2012-13 on Agriculture

INTRODUCTION

Agriculture remains the most important sector of the Indian economy whether it be the pre-independence or the post-independence period. This fact is emphatically proved by the large number of people who depend on it for their livelihood. Before starting any discussion on Indian agriculture, we must look into its ***special features***:

- From monetary point of view the share of agriculture sector in the economy remains at ***14.1 per cent of the GDP***[1]. In the fiscal 1950–51 agriculture accounted for 55.4 per cent in the GDP.
- The share of agriculture has been falling in the country's gross income while industrial and services sectors' shares have been on a rise constantly. But from the livelihood point of view still ***58.2 per cent*** people of India depend on agriculture[2] sector. This makes it a more important sector than the industry and the services (for Nepal and Tanzania the dependency for livelihood on agriculture is still higher at 93 per cent and 81 per cent, respectively). It means that 58.2 per cent of the population lives with only 13.9 per cent of the total income of the Indian economy—this fact clearly substantiates the reason why the people who depend on agriculture are poor. In the developed economies such as the USA, France, Norway, the UK and Japan, agriculture contributes only 2 per cent of their GDP with only 2 per cent people dependent on this sector for their livelihood.
- Agriculture is not only the biggest sector of the economy but also the most free private sector, too. It is the only profession which still carries no burden of individual income tax.
- This is the biggest ***unorganised sector*** of the economy accounting for more than 90 per cent share in the total unorganised labour-force (93 per cent of the total labour force of the economy i.e. 39.7 crores, is employed in the unorganised sector)[3] .
- India is among 15 leading exporters of agricultural products in the world. As per the International Trade Statistics 2011, published by the World Trade Organisation (WTO), India's agricultural exports amounted to US $ 23.2 billion with a **1.7** per cent share of world trade in agriculture in 2010. On the other hand, India's agricultural imports amounted to US $ 17.5 billion with a **1.2** per cent share of world trade in agriculture in 2010[4].
- According to the export figures, agriculture is deeply related to industrial growth and the national income in India—1 per cent increase in the agricultural growth leads to 0.5 per cent increase in the industrial output (growth) and 0.7 per cent increase in the national income of India.[5]
- The industrial sector was selected as the ***'prime moving force'*** of the economy in the late 1940s. But due to market failure the sector failed to lead the economy. Without increasing the income of the people who depend on agriculture for their livelihood, the market was not going to support the Industries. As a result, the Government of India announced agriculture as the prime moving force of the economy in 2002.[6]
- With 1 per cent increase in the share of agriculture in India's total exports, the money which flows to the agriculture is calculated to be Rs. 8500 crores[7].

- Agricultural ***growth rate*** has always been a matter of concern for the economy. As per the advance estimates for the 11th Paln (2007–12) whereas the economic growth rate is supposed to be 8.6 per cent, the agricultural growth rate is estimated to be at only 3.6 per cent[8].
- ***Productivity Gap*** *between on-the-field and ideal farm practices decreasing*. As per the recent release of the GoI, the average productivity of rice, wheat and pulses which was 2202 kg, 2802 kg and 625 kg per hectare in 2007-08 increased to 2346 kg, 3026 kg and 649 kg per hectare during 2011-12[9].
- Foodgrains production touched an ***'all-time high'*** of 259.32 MT in the year 2011-12 while it is estimated to moderate in 2012-13 to the level of 250.14 MT – due to deficiency in the South-West Monsoon and the resultant acerage losses – as per the *Economic Survey 2012-13, p. 175.*
- Nearly 66 per cent of the cropped area in the economy still depends on the uncertainties of ***monsoon*** for their irrigational requirements[10].

KHARIF & RABI

There are certain special terms used to understand the cropping seasons of India. The agricultural crop year in India is from *July to June.* The Indian cropping season is classified into two main seasons- (i) Kharif and (ii) Rabi based on the monsoon. The kharif cropping season is from *July to October* during the South-West/Summer Monsoon and the Rabi cropping season is from *October to March* (Nort/East/Returning/Winter Monsoon). The crops grown between March and June are summer crops, known as the *jayads*.

Pakistan and Bangladesh are two other countries that are using the term 'kharif' and 'rabi' to describe about their cropping patterns. The terms 'kharif' and 'rabi' originate from Arabic language where Kharif means *autumn* and Rabi means *spring*.

The kharif crops include rice, maize, sorghum, pearl millet/bajra, finger millet/ragi (cereals), arhar (pulses), soyabean, groundnut (oilseeds), cotton etc. The rabi crops include wheat, barley, oats (cereals), chickpea/gram (pulses), linseed, mustard (oilseeds) etc.

FOOD PHILOSOPHY OF INDIA

Indian food philosophy[11] is generally seen divided into three phases with their own objectives and challenges:

The First Phase

This phase continued for the first three decades after the independence. The main aim and the struggle of this phase was producing as much foodgrains as required by the Indian population i.e—achieving ***physical access*** to food.

The idea of Green Revolution at the end of this phase at least gave India the confidence of realising

the objective. At the end of 1980s, India was a self-sufficient country regarding food.

The Second Phase

Meanwhile India was celebrating its success of the first phase, a new challenge confronted India—achieving ***economic access*** to food. The situation went on worsening and by early 2000 there was a paradoxical situation in the country when it was having more than three times buffer stocks of foodgrains in the central pool but in several states people were dying due to lack of food—a complete mockery of the logic behind maintaining buffer stock, success of green revolution and the concept of India being a welfare state[12] ! The Supreme Court intervened after a PIL was filed by the People's Union for Civil Liberties (PUCL) and a national level Food for Work Programme came up (to be merged with the National Rural Employment Guarantee Scheme now). The courts took the governments on task if foodgrains rot either in godowns or destroyed in oceans to manage market price for the foodgrains, or if the centre had to go for exporting wheat at very low price. In this process India emerged as the ***seventh largest*** exporter of wheat (2002)! Basically, we were exporting the share of wheat which was not consumed by many Indians due to lack of economic reach to the food.

As the inputs of the Green Revolution were costlier, its output naturally were to be costlier. To fight the situation there should have been a time-bound and target-oriented macro-economic policy support which could deliver comparative increase in the purchasing capacity of the masses to make the food affordable for them. India badly failed in it. The crisis was managed by throwing higher and higher subsidies ultimately affecting government expenditure on the infrastructural shortcomings in the agriculture sector. Even after providing higher food subsidies, some people failed to purchase food and they were left with no option but to die of hunger!

India is still in this phase and trying to solve the crisis through twin approach firstly, by creating maximum number of gainful employment and secondly by cutting cost of the foodgrains (via the second green revolution based on the biotechnology).

It must be kept in mind that the food self-sufficiency happiness was a temporary thing for India. By the mid 1990s, India realised that its foodgrain production was lagging behind its population increase. It means India is still fighting to achieve physical reach to the required level of food.

The Third Phase

By the end of 1980s, world experts started questioning the very way world was carrying on with the different modes of production. Agricultural activitiy was one among them which had become hugely based on industries (chemical fertilisers, pesticides, tractors, etc.). All developed economies had declared their agriculture to be an industry.[13]

It was time to look back and introspect. By early 1990s, several countries started going for ecologically friendly methods and techniques of industrial, agricultural and services' sector development. The much-hyped Green Revolution was declared ecologically untenable and the world headed for organic farming, green farming, etc.

It meant that achieving physical and economic reach to food was not the only challenge India was facing but such aims should not be realised at the cost of the precious ecology and biodiversity—a

new challenge! India needed a new kind of green revolution which could deliver it the physical, economic as well as *ecological access* to the food—the Second Green Revolution—an all-in-one approach towards the agriculture sector.

LAND REFORMS

All economies were agrarian before they were industrialised, only their periods vary. Once democratic systems developed, the first thing the developed countries of today did was to complete the agrarian reforms in a time-bound way. As land remains the means of livelihood for the larger section of society in an agrarian economy, the successful completion of agrarian reforms benefitted the maximum number of people thereby improving their economic conditions. At the time of independence, India was a typical agrarian economy and had inherited a very inequitable agrarian system. Land reforms will be a major plank of the independent India and as part of the agrarian reforms it was made clear by the pledge of the Indian National Congress in 1935 itself. Land reforms in India had three objectives similar to the other economies which opted for it in the past:

(i) Removing ***institutional discrepancies*** of the agrarian structure inherited from the past which obstructed increasing agricultural production such as—the size of agricultural holding, land ownership, land inheritance, tenancy reforms, abolition of intermediaries, introduction of modern institutional factors to agriculture, etc.

(ii) The other objective of the land reforms in India was related to the issue of ***socio-economic inequality*** in the country. The high level inequality in land ownership had not only its negative economic impact on the economy but it was badly intertwined with caste system of India and the allocation of social prestige and status by the society at large[14]. More than 80 per cent of the population from its livelihood inherited the agrarian system which had inequitable ownership of the asset i.e. land to earn income. The government wanted to go for a restructuring of the land ownership in the economy on the logical grounds and with public welfare approach. This objective of the land reforms got enough socio-political attention as it tried to dismantle the age-old agrarian structure in the country. It became such a hot issue that land reforms in India got a ‘bad-name’, synonymous to land-grabbing by the government and allotting them to the landless masses.

(iii) The third objective of the land reforms in India was highly contemporary in nature which did not get enough sociopolitical attention—it was the objective of ***increasing agricultural production*** for solving the inter-related problems of poverty, malnutrition and food insecurity.

To realise the objectives of the land reforms, the government took three main steps which had many internal sub-steps:

1. Abolition of Intermediaries

Under this step, the age-old exploitative land tenure systems of the Zamindari, Mahalwari and Ryotwari were fully abolished.

2. Tenancy Reforms

Under this broader step, three inter-related reforms protecting the land tenants were effected:

(i) *Regulation of rent* so that a fixed and rational rate of rent could be paid by the share-croppers to the land owners;

(ii) *Security of tenure* so that a share-cropper could be feel secure about his future income and his economic security; and

(iii) *Ownership rights to tenants* so that the landless masses (i.e. the tenants, the share-croppers) could be transferred the final rights for the land they plough - *"land to the tillers"*.

3. Reorganisation of Agriculture

This step again has many inter-related and highly logical provisions in the direction of rational agrarian reforms:

(i) *Redistribution of land* among the landless poor masses after promulgating timely ***ceiling laws***—the move failed badly with few exceptions such as W. Bengal, Kerala and partially in Andhra Pradesh.

(ii) *Consolidation of land* could only succeed in the regions of the Green Revolution (i.e., Haryana, Punjab and Western Uttar Pradesh) and remained marred with many loopholes and corruption.

(iii) *Cooperative farming* which has a high socioeconomic moral base was only used by the big farmers to save their lands from the draconian ceiling laws.

The whole attempt of land reforms in India is considered a big failure by the majority of experts. Many consider the issue of land reforms in India as the most complex socioeconomic problem of human history[15]. The data regarding the numerical achievements of the land reforms have been highly discouraging[16].

(i) Tenancy reforms made tenants have their rights but only on 4 per cent of the total operated area of India (14.4 million hectares of operated area by the 11 million tenants by 1992);

(ii) Redistribution of ownership rights of land took place but on only 2 per cent of the total operated area of the country (less than 2 million hectares among the 4.76 million people by 1992);

(iii) Taken together, the whole process of land reforms could benefit only 6 per cent of the operated area of the country with a negligible socioeconomic positive impact.

It was the failure of the land reforms which made the government easily attracted towards the new policy of the Green Revolution in the coming times—land reforms had failed to increase the agricultural production thus the government opted the route of increasing the productivity to reach the same goal i.e., the initiation of the new techiques of agriculture.

Reasons for Failure of Land Reforms

Out of many reasons forwarded by the experts responsible for the failure of the land reforms in India, the following three could be considered the most important ones:

(i) Land in India is considered a symbol of social prestige, status and identity unlike the other economies which succeeded in their land reform programmes where it is seen as just an economic asset for income-earning;

(ii) Lack of political will which was required to affect the land reforms and make it a successful programme; and

(iii) The rampant corruption in public life, political hypocricy and leadership failure in the Indian democratic system.

Land Reforms & Green Revolution

Once the Government launched the Green Revolution (GR), the issue of land reforms (LR) almost got marginalised due to the following reasons:

(i) There is an inherent diabolic relationship between the GR and the LR as the former suits to bigger and economic land holdings the latter intended to fragment the land among a large number of the masses.

(ii) The LR was socially opposed by the land-owning caste lobbies while there was no such opposition to the GR.

(iii) The level of legislative attempts taken by the governments regarding the LR till date had almost no positive socioeconomic impact on the country while the GR was having all potential of proving higher yields of the foodgrains.

(iv) The subsidised supplies of foodgrains under PL480 were hampering India from carving out its independent diplomacy, as well as there has always remained a doubt about the regular supplies of wheat.

(v) International pressure as well as the suggestions from the World Bank besides the success stories of the GR from the countries where it had increased the yield of wheat.

Land Reforms & Economic Reforms

Once economic reforms started in early 1990s, the issue of the LR looks logically going to the back burner. Though many state governments have revived their new commitments to the matter of the LR, the market economy approach to reform hardly got materialised.

The central government is doing everything to increase agricultural production, specially to achieve ***food security***. Besides, unless India grows surplus agricultural produce the benefits of globalisation in the WTO regime would not be accruing to the agriculture sector and the masses who depend on it for their livelihood would miss the train to their prosperity and development. The government's emphasis and permission for ***corporate farming*** and ***contract farming*** has been praised by the experts in India and abroad alike. Yet, sociopolitical acceptance of these new methods of farming are yet to crystallise.

Meanwhile, the soul of the land reforms needs modification to go parallel with the process of economic reforms.

Agriculture Holdings

The average size of land holding in India is continuously decreasing due to rapid and high population growth. The continuous division and fragmentation of holdings has increased the number of holdings, obviously of smaller size. According to the results of Agriculture Census 1990–91:

- The total number of operational holdings in the country had increased from 972 million in 1985–86 to 1066 million in 1985–86 to 1066 million in 1990–91.
- Operated area, on the other hand, had risen only marginally, i.e., by about 0.6 per cent. Rise in the number of holdings without corresponding increase in area clearly showed pressure of population on land with average size of holding declining from 1.69 hectare in 1985–86 to 1.55 hectare in 1990–91. 59 per cent of total operational holdings in 1990–91 were of size less than 1 hectare (i.e., marginal holdings), 32.2 per cent of size between 1–4 hectare (i.e., small holdings), 7.2 per cent of size between 4–10 hectares (i.e., medium holdings) and only 1.6 per cent of size more than 10 hectares (i.e., large holdings).
- In 1985–86, Rajasthan had the highest average holding size of 4.34 hectares, followed by Punjab having an average size of 3.77 hectares. Contrary to it, Kerala was having the lowest average holding size of 0.36 hectares (1985–86 data are the latest.) Agricultural holdings have been classified into ***three*** categories:

1. Economic Holding

It is that holding which ensures a minimum satisfactory standard of living to a family. In other words, economic holding is a minimum essential area for profitable agriculture.

2. Family Holding

Family holding is that holding which gives work to average size family having one plough under traditional farming system. In other words, family holding is a ***'plough unit'*** which is neither less nor more for an average size family to cultivate it properly.

3. Optimum Holding

Maximum size of the holding which must be possessed and owned by a family is called optimum holding.

Computerisation of Land Records

Two Centrally Sponsored Schemes viz. (i) Computerisation of Land Records (CLR) and (ii) Strengthening of Revenue Administration and Updating of Land Records (SRA & ULR) are being administered by Land reforms Division in the Department of Land Resources[17].

The Centrally Sponsored Scheme on Computerisation of Land Records (CLR) was started in 1988–89 with 100 per cent financial assistance as a pilot project in eight districts, viz., Rangareddy (A.P.), Sonipur (Assam), Singhbhum (Jharkhand), Gandhinagar (Gujarat), Morena (M.P.), Wardha (Maharashtra), Mayurbhanj (Orissa) and Dungarpur (Rajasthan) with a view to remove the problems inherent in the manual systems of maintenance and updating of land records and to meet the requirements of various groups of users. It was decided that efforts should be made to computerise

core data contained in land records, so as to assist development planning and to make records accessible to people/planners and administrators.

At present, the scheme is being implemented in ***582*** districts of the country excepting those districts where there are no land records. A decision was taken during 1997–98 for operationalisation of the scheme at the tehsil/taluk level for facilitating delivery of computerised land records to users and public at large. Under this programme, funds are released to the state governmentsfor purchase of hardware, software and other peripheral equipment.

GREEN REVOLUTION

It is the introduction of new techniques of agriculture which became popular by the name of the Green Revolution (GR) around the world in early 1960s—at first for ***wheat*** and by the next decade for ***rice***, too. It revolutionised the very traditional idea of food production by giving a boost by more than 250 per cent to the productivity level.[18] The Green Revolution was centred around the use of the High Yielding variety (HYV) of seeds developed by the US agro-scientist Norman Borlaug doing research on a British Rockfellor Foundation Scholarship in Mexico by the early 1960s. The new wheat seeds which he developed *in vivo* claimed to increase its productivity by more than 200 per cent. By 1965, the seeds were successfully tested and were being used by farmers in food deficient countries such as Mexico, Taiwan.

Components of the Green Revolution

The Green Revolution was based on the timely and adequate supply of many inputs/components. The components of the G.R. and a brief introductions follows:-

1. The HYV Seeds

They were popularly called the '***dwarf***' variety of seeds. With the help of repeated mutations, Mr. Borlaug had been able to develop a seed which was raised in its nature of nutrients supplied to the different parts of the wheat plant—against the leaves, stem and in favour of the grain. This made the plant dwarf and the grain heavier—resulting into high yield[19].

These seeds were non-photosynthetic, hence non-dependent on sun rays for targeted yields!

2. The Chemical Fertilizers

The seeds were to increase productivity provided they got sufficient level of nutrients from the land. The level of nutrients they required could not be supplied with the traditional compostes because they have low concentration of nutrients content and required bigger area while sowing—it meant it will be shared by more than one seed! That is why a high concentration fertilizer was required which could be given to the trageted seed only—the only option was the chemical fertilizers—the urea (N), the phosphate (P) and the potash (K).[20]

3. The Irrigation

For controlled growth of crops and adequate dilution of fertilizers, a controlled means of water supply was required. It made two important compulsions—firstly the area of such crops should be at least free of flooding and secondly, artificial water supply should be developed.[21]

4. Chemical Pesticides and Germicides

As the new seeds were new and non-acclimatised to local pests, germs and diseases than the established indigenous varieties, use of pesticides and germicides became compulsory for result-oriented and secured yields.

5. Chemical Herbicides and Weedicides

To prevent costlier inputs of fertilisers not being consumed by the herbs and the weeds in the farmlands, herbicides and weedicides were used while sowing the HYV seeds.

6. Credit, Storage, Marketing/Distribution

For farmers to be capable of using the new and the costlier inputs of the GR, availability of easy and cheaper credit was a must. As the farmlands suitable for this new kind of farming was region-specific (as it was only Haryana, Punjab and Western Uttar Pradesh in India) storage of the harvested crops was to be done in the region itself till they were distributed throughout the country. Again, the countries which went for the GR were food-deficient and needed the new yield to be distributed throughout the country and a proper chain of marketing, distribution and transport connectivity was necessary. All these peripheral infrastructure were developed by the countries going for the GR with softer loans coming from the World Bank—India being the biggest beneficiary.[22]

Impact of the Green Revolution

The GR had its positive as well as negative socioeconomic and ecological impacts on the countries around the world, we will specially study India here:

1. Socio-economic Impact

Food production increased in such a way (wheat in 1960s and rice, too by 1970s) that many countries became self-sufficient (self sufficiency of food must not be confused with the idea of food security!) and some even emerged as food exporting countries too.

But the discrepancy in farmers' income it brought with itself increased the inter-personal as well as inter-regional disparities/inequalities in India[23]. Rise in the incidence of malaria due to water-logging, a swing in the balanced cropping patterns in favour of wheat and rice putting pulses, oilseeds, maize, barley on the margins, etc. were the negative impacts.

2. Ecological Impact

The most devastating negative impact of the GR had been the ecological one. When the issues related with it were raised by the media, scholars, experts and the environmentalists, neither the governments nor the masses (what to say of the farmers of the GR region! they were not educated enough to the side effects of the inputs of the GR!) were convinced. But a time came when the government and the government agencies both started doing studies and surveys focused around the ecological and environmental issues. The major ones among them may be glanced in their chronological order:

I. Critical Ecological Crisis On the basis of on-field studies[24] it was found that critical ecological crises in the GR region are showing up—

(a) *Soil fertility being degraded* (due to the repititive kind of cropping pattern being followed by the farmers as well as the excessive exploitation of the land; lack of a suitable crop combination and the crop intensity; etc.).

(b) *Water table falling down* (as the new HYV seeds required comparitively very high amount of water for irrigation—5 tonnes of water needed to produce 1 kg of rice!.

(c) *Environmental degradation* due to excessive and uncontrolled use of chemical fertilisers, pesticides and herbicides have degraded the environment by increasing pollution levels in land, water and air. In India it is more due to *deforestation* and extension of cultivation in ecologically fragile areas. At the same time, there is an excessive pressure of animals on forests—mainly by goats and sheeps).

II. Toxic Level in Food Chain Toxic level in the food chain of India has increased to such a high level that nothing produced in India is fit for human consumption. Basically, unbridled use of chemical pesticides and weedicides and their industrial production combined together had polluted the land, water and air to such an alarmingly high level that the whole food chain had been a prey of high toxicity.

Conclusion

The above studies and the report were eye-openers in the area of ecologically non-sustainable kind of agriculture as well as a big question mark on it. This was the time when agro-scientists suggested for a really 'green' (eco-friendly) green revolution which is today known among the experts with many more names-the *evergreen revolution,* the *second*—green revolution the *green farming*.

MINIMUM SUPPORT PRICES (MSP)

The Government of India started announcing the Minimum Support Prices (MSP) in 1966–67 for wheat which was expanded to cover many more crops in the coming years in the wake of the Green Revolution which might have resulted into fall in prices of wheat depleting farmers' profit. It is a minimum price at which the government will purchase farmers' crops—whatever may be the market price for the crops.[25]

PROCUREMENT PRICES

Besides the minimum support prices (MSP) which was announced before sowing started, the government started announcing procurement prices (after the harvesting of the crops) at which it purchased the crops from the farmers. Procurement prices were announced higher than the MSP since the government was lagging behind when its foodgrain procurement required to maintain the buffer stocks. But this increased price hardly served the purpose as a suitable incentive to farmers. It would have been better had it been announced before sowing and not after harvesting. Since the fiscal 1968-69 the government announced only the MSP which is considered the procurement price, too.[26]

ISSUE PRICE

The price at which the foodgrains are allowed by the government to offtake from the FCI—this is the price at which the FCI sells its foodgrains. The FCI has been incurring huge losses in the form of food subsidies.[27]

The government-procured foodgrains are stored temporarily in the concerned states of their purchase and then transported to their decided FCI godowns as part of the buffer stock. From here they head to the sale counters. The transportaion, godowning, the cost of maintaining the FCI, grain losses make the foodgrains touch higher price that are never affordable by the masses. That is why the issue prices have never been market-based prices. The gap is considered as the element of the food subsidy in India.

BUFFER STOCK

India has a policy of maintaining a minimum reserve of foodgrains (only for wheat and rice) so that food is available throughout the country at affordable prices round the year. The main supply from here goes to the public distribution system (now TPDS) and at times goes to the open market to check the rising prices if needed. As per the current Buffer Stocking Policy[28] of foodgrains, the minimum stocks on different dates is required to be mentioned given below:

Date	*Wheat*	*Rice*	*Total*
1st April	4.0	12.2	16.2
1st July	17.1	9.8	26.9
1st October	11.0	5.2	16.2
1st January	8.2	11.8	20.0

ECONOMIC COST OF FOODGRAINS

The economic cost of foodgrains consists of *three* components, namely the MSP (and bonus if applicable) as the price paid to the farmers, procurement incidentals, and the cost of distribution. The economic cost for both wheat and rice witnessed significant increase during the last few years due to

increase in MSPs and proportionate increase in the incidentals between the period 2002-03 and 2010-11 per kg burden on wheat and rice has increased to Rs. 15 (from Rs. 9) and Rs. 20 (from Rs. 12), respectively[29].

DECENTRALISED PROCUREMENT SCHEME

The decentralised procurement scheme of the Government of India that is in operation since 1997 has evoked good response from the State Governments. Under this scheme, the designated States procure, store and also issue foodgrains under TPDS. The difference between the economic cost of the State Governments and the central issue price (CIP) is passed on to the State Governments as subsidy. The decentralised system of procurement, helps to cover more farmers under the MSP operations, improves efficiency of the PDS, provides varieties of foodgrains more suitable to local taste, and reduces the transportation costs of the FCI[30].

RISING FOOD SUBSIDY

Provision of minimum nutritional support to the poor through subsidised foodgrains and ensuring price stability in different states are the ***twin objectives*** of the food security system. In fulfilling its obligation towards distributive justice, the government incurs food subsidy[31]. While the economic cost of wheat and rice has continuously gone up, the issue price has been kept unchanged since 1 July, 2002. The government, therefore, continues to provide large and growing amounts of subsidy on foodgrains for distribution under the TPDS, other nutrition-based welfare schemes, and open market operations. The food subsidy expenditure[31] has increased substantially in the past few years putting severe strain on the public exchequer from a total of Rs. 17,494 crore in 2001-02 it has gone to the level of Rs. 62,929 crore by 2010-11. The fiscal outgo is expected to be more once the proposed National Food Security Act is implemented.

NATIONAL FOOD SECURITY BILL

The National Food Security Bill was introduced in the Lok Sabha on 22 December, 2011. As per the provisions of the Bill, it:

- Is proposed to provide 7 kg. of foodgrains per person per month belonging to priority households at prices not exceeding Rs. 3 per kg of rice, Rs. 2 per kg of wheat, and Rs. 1 per kg of coarse grains and to general households not less than 3 kg of foodgrains per person per month at prices not exceeding 50 per cent of the MSP for wheat and coarse grains and derived MSP for rice.
- It will benefit up to 75 per cent of rural population (with at least 46 per cent belonging to priority households) and up to 50 per cent of urban population (with at least 28 per cent

belonging to priority households), besides providing nutritional support to women and children and meals to special groups such as destitute and homeless, emergency and disaster affected, and persons living in starvation. Pregnant and lactating women will also be entitled to maternity benefit of Rs. 1,000 per month for six months.

- In case of non-supply of foodgrains or meals, entitled persons will be provided food security allowance by the concerned state/UT governments. Provisions for reforms in the TPDS such as doorstep delivery of foodgrains, application of information and communication technology (ICT) including end to end computerisation, leveraging 'aadhaar' for unique identification of beneficiaries have also been made in the Bill. Provisions have also been made for transparency and accountability including disclosure of records relating to the PDS, social audits, and setting up of vigilance committees besides an elaborate grievance redressal mechanism.

SUGAR SECTOR REFORMS

India is the largest consumer and second largest producer of sugar after Brazil. Sugar and Sugarcane are notified as essential commodities under the Essential Commodities Act 1955. The production of sugarcane during 2012-13 is estimated at 334.54 million tonnes. However, the Indian sugar sector suffers from policy inconsistency and unpredictability. The Sugar industry in India is over-regulated and prone to *cyclicality* due to price interventions. Deregulation of the sugar industry has been widely debated for a long time. From a purely economic point of view, greater play of market forces would provide better prices and serve the interests of all stakeholders. The government should come into the picture only in situations where absolutely necessary. Export bans and controls could be replaced with small variable external tariffs to stabilize prices. A report on *'Regulation of the Sugar Sector in India: The way forward'* has been submitted by the Committee under the chairmanship of Dr C. Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister – the measures suggested are as follows*–

a. phasing out cane reservation area;

b. dispensing with minimum distance criteria;

c. dispensing with the levy sugar system;

d. states that want to provide sugar under the PDS may procure it from the market according to their requirement, fix the issue price and subsidize from their own budgets (Till April 4, 2013, when the GoI 'decontrolled' the sugar industry from the burden of 'levy' to the tune of 10 per cent of their total production, there was an implicit cross-subsidy on account of the levy as sugar mills were under a transition). The Report suggested some level of central support to help states meet the cost to be incurred on this account may be provided for a transitory period (which has been announced on April 4, 2013);

e. dispensing with the regulated release mechanism (of non-levy) sugar;

f. stable trade policy;

g. no quantitative or movement restrictions on byproduct like molasses and ethanol and dispensing with compulsory jute packing.

h. a stable, predictable, and consistent policy reforms to be brought about in a fiscally neutral manner and issues considered for implementation in a phased manner.

In the meanwhile, following on the path of ongoing *'factor market reforms'* the GoI decontrolled the sugar industry in *April 2013* – effective for the 'sugar year' September 2012 - August 2013. It abolished the decades-old practice of regulating 'how much sugar a mill can sell in the open market' and the 'levy' system in which a company is forced to sell 10 per cent of the output at a loss to the FCI for supplies through the PDS (Public Distribution System) – they will be no more under the levy obligation. The *next move* of reform may be 'linking sugar and sugarcane prices'. To continue subsidised supply to the poor, states will now have to buy sugar at market rates and maintain the existing PDS sale price of Rs 13.50 per kg, which has not been revised for a decade and is substantially lower than the average market price of Rs. 35 per kg.

EDIBLE OIL ECONOMY

India is one of the largest producers of oilseeds in the world. However, 50 per cent of its domestic requirements are today, met through imports, out of which crude palm oil and the RBD (Refined, Bleached and Deodorised) palmolein constitute about 77 per cent and soyabean oil constitutes about 12 per cent. The *Economic Survey 2012-13* provides some valuable and timely advisory inputs on the 'edible oil sector' of India in the following way –

i. Import dependence was about 3 per cent during 1992-93. The production of oilseeds, though it has increased in recent years (from 184.40 lakh tons in 2000-01 to 297.99 lakh tons in 2011-12), it has not kept pace with the demand for edible oils in India. Imports have helped raise the per capita availability of edible oils which has increased from 5.8 kg in 1992-93 increased to 14.5 kg in 2010-11.

ii. One instrument for promoting future domestic production is calibration of the import duty structure. Large imports of edible oils are primarily due to competitive prices of edible oils in the international market and the import duty structure which has been sharply reduced to *near zero* levels over time to protect consumers – India has such a high market share (in the world edible oil imports) that allows it to set some independent tariff policy that can meet both goals better.

iii. Considering the situation, it is time to frame a price band for edible oils in a manner that harmonizes the interests of domestic farmers, processors, and consumers through imposition of import duty at an appropriate rate.

iv. The import duty would also generate revenue, which could also be utilized for an 'oilseeds development programme'.

v. Recently the tariff value of all edible oils (which had remained unchanged since 2006) was updated to market levels. This is a right step for aligning the tariffs to current prices for edible oils in the international market. By freezing the tariff value, imports had become more attractive than domestic refining. Over time, domestic oil palm production may also gain.

vi. India is also fortunate in having a wide range of oilseed crops grown in its different agro-climatic zones, including high-value premium crops. Recently, export of edible oils in

branded consumer packs upto 5 kg has been allowed without any quantitative limit having minimum export price (MEP) of US $ 1500 per ton in order to encourage export of high value premium edible oils. Farmers respond to prices. The aim of policy is to consistently enhance their competitiveness.

AGRICULTURAL MARKETING

The role of the agriculture market[32] is to deliver agricultural produce from the farmer to the consumer in the most efficient way. Agriculture markets are regulated in India through the APMC Acts. According to the provisions of the APMC Acts of the states, every APMC (Agricultural Produce Marketing Committee) is authorised to collect market fees from the buyers/traders in the prescribed manner on the sale of notified agricultural produce. The relatively high incidence of commission charges on agricultural/horticultural produce renders their marketing cost high, which is an undesirable outcome. All this suggests that a single point market fee system is necessary for facilitating free movement of produce, bringing price stabilisation, and reducing price differences between the producer and consumer market segments. Another point to be highlighted is that the cleaning, grading, and packaging of agricultural produce before sale by the farmers have not been popularised by these market committees on a sufficient scale.

Nevertheless, there have been some achievements in leading states like Maharashtra, Karnataka, Andhra Pradesh and Gujarat since the Model APMC Act 2003 has been implemented in those states. Some state governments have granted licences to the private sector for setting up of markets and direct purchase from the farmers in order to provide alternative marketing channels. There is considerable potential for agricultural markets to be competitive. As the APMC was created to protect the interests of farmers, it will be in the fitness of things to give farmers the choice of going to the APMC or not. In the light of this, the need is to pursue further reforms in the state APMC Acts.

E-CHOUPAL [33]

The e-Choupal, the first private sector initiative by the private sector in agricultural marketing, is a business platform consisting of a set of organis-ational subsystems and interfaces connecting farmers to global markets. This common structure can be leveraged to procure/provide a host of products and services for the farmer as a producer as well as a consumer. The e-choupal business platform consists of three layers, each at different levels of geographic aggregation. Each of the three layers is characterised by three key elements:

(a) The infrastructure (physical or organisational) through which transactions take place,

(b) The entity (person or organisation) orchestrating the transactions, and

(c) The geographical coverage of the layer.

The first layer consists of the village-level kiosks with internet access (or e-Choupal), managed by an ITC-trained local farmer (called a Sanchalak) and within walking distance (1–5 kilometres) of each target farmer. The relatively sparse population density in rural India justified the location of one e-

Choupal per cluster of five villages. The second layer consists of a bricks-and-mortar infrastructure (called hubs) managed by the traditional intermediary who has local knowledge/skills (called a Samyojak in his new role) and within tractorable distance (25–30 kilometres) of the target farmer. The ITC chose to operate the platform on the following three business principles:

(a) Free information and knowledge which ensures wider participation by the farmer.

(b) Freedom of choice in transactions (farmers, after accessing information at the e-Choupal, are free to transact their own way).

(c) Transaction-based income stream for the Sanchalak by tying his revenue stream to the transaction (on a commission basis).

TRIFED

The Government established TRIFED (Tribal Co-operative Marketing Development Federation of India Ltd.) in August 1987. The basic aim of TRIFED was to save tribals from exploitation by private traders and to offer them remunerative prices for their minor forest produce and surplus agriculture products. TRIFED started functioning in April 1988. TRIFED has also been declared an important agency for collecting, processing, storing and developing oil seeds products. TRIFED plays the role of an agent of FCI for Government purchase of wheat and rice. It is also an agent of agriculture and cooperation department of Government for purchase of cereals, pulses and oil-seeds. Agriculture Ministry gives aid to TRIFED for compensation loss incurred due to price fluctuations.

NAFED

NAFED (National Agricultural Co-operative Marketing Federation of India Ltd.) has been established in co-operative sector at national level for marketing of agriculture products.

STORING FACILITIES FOR AGRICULTURE PRODUCTS

To promote storing facilities for agriculture products, National Co-operative Development & Warehousing Board (1956) and Central Warehousing Corporation (1957) were established. State Warehousing Corporations were also established. Presently FCI has its own warehouses.

AGRICULTURAL CREDIT

Three types[34] of loans are provided to Indian farmers to meet their financial requirements—

(a) Short term loans

(b) Medium term loans

(c) Long term loans

Short Term Loans

Short term loans are provided for a period of less than 15 months to meet out expenses of routine farming and domestic consumptions. This type of loan is demanded by farmers for purchasing seeds, fertilisers and for meeting out family requirements.

Medium Term Loans

Medium term loans are provided for a period of 15 months to 5 years to purchase agricultural equipment, animals and for land improvements.

Long Term Loans

Long term loans are provided for a period of more than 5 years. This type of loan is taken by the farmers to purchase land and expensive agricultural equipment and for repayment of old loans.

Source of Loans

The Indian farmer can acquire the above types of loans from two sources:

(a) Non-institutional sources like moneylenders, landlords, big businessmen, etc[35].

(b) Institutional sources like commercial Banks, Co-operative Banks and Government sources.

Policy on agriculture credit aims at progressive institutionalisation of credit agencies for providing credit to farmers for raising agricultural production and productivity. Agricultural credit is disbursed through a multiagency network consisting of Co-operatives, Commercial Banks and Regional Rural Banks (RRBs).

COMMODITY FUTURES MARKET

The commodity futures market facilitates the ***price discovery*** process and provides a platform for *price risk management* in commodities. Currently, 113 commodities are notified for futures trading of which 50 are actively traded in five national and 16 commodity specific ***exchanges***. Agricultural commodities, bullion, energy, and base metal products account for a large share of the commodities traded in the commodity futures market. The total value of trade in the commodity futures market rose significantly in 2011 compared to that of the previous year due to increased awareness, the advent of new commodity exchanges, increase in global commodity prices, and improved regulation.

To strengthen and broad base the market, the Forward Markets Commission (FMC), which is ***the regulator*** for commodity futures trading under the provisions of the Forward Contracts (Regulation) Act 1952, has taken many initiatives[36]:

(i) Conducted awareness programmes during 2011 such as a media campaign under the ***Jago Grahak Jago Programme*** about the Dos and Don’ts of trading in the commodity futures

market;

(ii) Police training programmes in the states of Madhya Pradesh, Chhattisgarh, Tamil Nadu, and Delhi with regard to dabba trading/ illegal trading;

(iii) A massive awareness and capacity-building programme for various stakeholder groups, with primary focus on farmers.

(iv) On the regulatory front, the FMC undertook measures for the development of the commodity futures market which include ensuring more effective inspection of members of the exchanges on regular basis and in a comprehensive manner covering all aspects of regulatory regime;

(v) bringing out a guidance manual for improving audit practices, prescribing penalty structure for client code modification and for executing trade; and

(vi) granting exemptions for short hedge for soyabean/oil futures, issuing directives for segregation of client accounts.

FARM WASTE DEBATE

A recent study[37], undertaken by the *Central Institute of Post-Harvest Engineering and Technology (CIPHET)*, a government-run institute, has estimated the value of farm waste in India at Rs 44,000 crore (at the prices of 2009), that is around 7% of the total produce which is much lower than the oft-stated 40% level. Although cereals, such as wheat and rice, pulses and oil seeds accounted for around two-thirds of the wastage, the loss in case of fruits and vegetables was the highest at up to 18% of the total produce.

Attending the causes of storage and processing facilities, something the GoI is emphasising, this level could come down significantly and can serve great purpose in helping the economy to fight the repeated price shocks of the past two years in case of fruits, vegetables and foodgrains to a great extent.

The losses take place in almost all stages of farming but ***the study*** looked at harvesting, collection, grading, cleaning, packaging, transportation and storage. If cultivation was also included the loss would figure would be much higher. The GoI has said that availability of better technology and their adoption has brought about a reduction in losses.

IRRIGATION

The Planning Commission[38] classifies irrigation projects/schemes in India on the following lines :

1. *Major Irrigation Schemes*—Those with cultivable command areas (CCA) more than 10,000 hectares.
2. *Medium Irrigation Schemes*—Those with cultivable command areas (CCA) between 2,000 and 10,000 hectares.
3. *Minor Irrigation Schemes*—Those with cultivable command area (CCA) upto 2,000 hectares. Expansion of irrigation facilities, along with consolidation of the existing systems, has been

the main part of the strategy for increasing production of foodgrains.

With a view to ensuring early completion of projects for providing irrigation benefits to the farmers, ***Rural Infrastructure Development Fund*** (RIDF) has been in operation since 1995–96. The Government launched ***Accelerated Irrigation Benefits Programme*** (AIBP) in 1996–97.

The Accelerated Irrigation Benefit Programme (AIBP) was launched during 1996–97 to give loan assistance to the States to help them complete some of the incomplete major/medium irrigation projects which were in an advanced stage of completion.

NATIONAL FOOD SECURITY MISSION (NFSM)

The NFSM, launched in 2007, is a **crop development** scheme of the Government of India that aims at additional production of 10, 8, and 2 million tonnes of rice, wheat, and pulses, respectively by the end of 2011-12. The Mission interventions consist of[39]:

(a) seeds of improved variety
(b) soil ameliorants
(c) plant nutrients
(d) farm machines/implements, and
(e) plant protection measures

In addition, a special initiative under the name of the *Accelerated Pulses Production Programme* was initiated in 2010 to boost the production of pulses by active promotion of technologies in 1,000 clusters of 1,000 ha (hectare) each.

Considerable achievements under the NFSM have been recorded during the course of implementation of the programme such as new farm practices, distribution of seeds of high yielding varieties of rice, wheat, pulses, and hybrid rice, and treating area with soil ameliorants to restore soil fertility for higher productivity. Through targeted interventions, the mission has already achieved, a year in advance, 25 millions tonnes of additional production of foodgrains exceeding the target of 20 million tonnes of production set for the terminal year 2011-12, of the 11th Plan.

MACRO MANAGEMENT OF AGRICULTURE (MMA)

The MMA was revised in 2008 to improve its efficacy in supplementing/complementing the **efforts of the states** towards enhancement of agricultural production and productivity[40]. It also provides opportunity to draw upon agricultural development programmes out of ten sub-schemes relating to crop production and natural resource management, and give it the flexibility to use 20 per cent of resources for innovative components.

The revised MMA scheme has formula-based allocation criteria and provides assistance in the form of grants: loan to the states/UTs on 90:10 ratio basis, except in case of the north-eastern states where

the central share is 100 per cent grant.

RASHTRIYA KRISHI VIKAS YOJANA (RKVY)

The RKVY was launched in 2007-08 for incentivising states to enhance public investment to achieve 4 per cent growth rate in agriculture and allied sectors during the 11th Plan[41]. The RKVY format permits taking up national priorities as sub-schemes, allowing the states flexibility in project selection and implementation. The sub-schemes include –

(i) Bringing Green Revolution to Eastern Region;
(ii) Integrated Development of 60,000 Pulses Villages in Rainfed Areas;
(iii) Promotion of Oil Palm;
(iv) Initiative on Vegetable Clusters;
(v) Nutri-cereals;
(vi) National Mission for Protein Supplements;
(vii) Accelerated Fodder Development Programme;
(viii) Rainfed Area Development Programme; and
(ix) Saffron Mission.

The RKVY links 50 per cent of central assistance to those states that have stepped up percentage of State Plan expenditure on agriculture and allied sectors. States have indeed increased allocation to agriculture and allied sectors from 4.88 per cent of total State Plan expenditure in 2006-07 to 6.04 per cent of in 2010-11 *(as per the Revised Estimates, Economic Survey 2011-12)*.

ISOPOM

The centrally sponsored ISOPOM (Integrated Scheme Of Oilseeds, Pulses, Oil Palm, And Maize)[42] have been under implementation during the Eleventh Plan in 14 states for oilseeds and pulses, 15 for maize, and 9 for oil palm. The pulses component has been merged with the NFSM with effect from 1 April 2010. Oilseeds are raised mostly under rainfed conditions and are important for the livelihood of small and marginal farmers in the arid and semi-arid areas of the country.

NATIONAL HORTICULTURE MISSION(NHM)

The horticulture sector includes a wide range of crops, such as fruits, vegetables, roots and tuber crops, flowers, aromatic and medicinal plants, spices, and plantation crops, which facilitate diversification in agriculture. It has been recognised that growing horticulture crops is now an ideal option to improve livelihood security, enhance employment generation, attain food and nutritional

security, and increase income through value addition. Over the years, there have been noticeable achievements and significant improvement in the production and productivity of various horticulture crops.

The NHM scheme was launched[43] during the Tenth Plan for **holistic development** of the horticulture sector, duly ensuring *forward* and *backward linkages* by adopting a *cluster approach,* with the active participation of all the stakeholders. The supply of quality planting material through establishment of nurseries and tissue culture units, production and productivity improvement programmes through area expansion and rejuvenation, technology promotion, technology dissemination, human resource development, creation of infrastructure for post-harvest management and marketing in consonance with the comparative advantages of each state/region and their diverse agro-climatic conditions are the major programmes of the Mission. A major initiative has been taken during 2011-12 for enhancing the supply of good quality vegetables to metro cities under the *Vegetable Initiative in Urban Clusters (VIUC).*

NATIONAL BAMBOO MISSION(NBM)

The NBM, a centrally sponsored scheme of the Ministry of Agriculture for harnessing the potential of the bamboo crop in the country, is under implementation in 27 states. It envisages promoting *holistic growth of the bamboo sector* by adopting an area-based, regionally differentiated strategy to increase the area under bamboo cultivation and marketing[44]. Under the Mission, steps have been taken to increase the availability of quality planting material by supporting the setting up of new nurseries/tissue culture units and strengthening existing ones. To address forward integration, the Mission is taking steps to strengthen marketing of bamboo products, especially those of handicraft items. Besides the Mission has provided financial assistance to different institutions/universities for twenty-three R&D projects aimed at higher productivity of bamboo. Agro-forestry trials comprising bamboo grown along with agricultural/horticultural crops and medicinal plants under different agro-climatic conditions in various states have been initiated.

NATIONAL AGRICULTURAL POLICY, 2000[45]

Union Government has announced new National Agricultural Policy in the parliament on July 28, 2000. This policy has been planned under the provisions of ***World Trade Organisation*** so as to face the challenges of agriculture sector. This policy gives emphasis on promoting agricultural exports after fulfilling domestic demand. The salient features[46] of this policy are:

- Four per cent growth rate p.a. for the next two decades.
- Four per cent growth rate p.a. target to be achieved by 2005.
- Land reforms to provide land to poor farmers.
- Consolidation of holding in all states of the nation.
- Promoting private investments in agriculture.

- To provide insurance umberalla for crops to farmers.
- To promote bio-technology.
- Promoting research for developing new varieties and ensuring protection to the developed varieties.

AGRICULTURAL INSURANCE

There are various major crop insurance schemes under implementation in the country:

(i) *National Agricultural Insurance Scheme (NAIS):* The NAIS is a government-sponsored central-sector crop insurance scheme being implemented in the country since 1999-2000 season (the erstwhile *Comprehensive Crop Insurance Scheme-CCIS* of 1985 was merged into it) with the **objective** of providing financial support to farmers in the event of failure of crops as a result of *natural calamities, pests, and diseases.* The Agriculture Insurance Company of India Ltd. (AICIL) is the implementing agency for the Scheme. At present, the scheme is being implemented by 25 states and two UTs[47].

(ii) *Modified NAIS (MNAIS):* With the aim of further improving crop insurance schemes, the MNAIS is under implementation on **pilot basis** in 50 districts in the country from rabi 2010-11 season. Some of the major improvements made in the MNAIS are[48]–

- *Actuarial premium* with *subsidy in premium* at different rates
- All claims liability to be on the insurer
- Unit area of insurance reduced to village panchayat level for major crops
- Indemnity for prevented/sowing/planting risk and for post-harvest losses due to cyclone
- On account payment up to 25 per cent advance of likely claims as immediate relief
- More proficient basis for calculation of threshold yield, and
- Allowing privatesector insurers with adequate infrastructure

Only upfront premium subsidy is shared by the central and state governments on 50: 50 basis and claims are the liability of the insurance companies. The scheme has been notified by 17 states by now.

(iii) *Pilot Weather Based Crop Insurance Scheme (WBCIS):* Being implemented as a central-sector scheme from kharif 2007 season. The scheme[49] is intended to provide protection to farmers *against adverse weather incidence,* such as deficit and excess rainfall, high or low temperature, and humidity that are deemed to adversely impact crop production. This is based on actuarial rates of premium but to make the scheme attractive, premium actually charged from farmers has been restricted to be on a par with the NAIS.

(iv) *Krishi Shramik Suraksha Yojana:* The multi-benefit scheme[50] for the agricultural workers, commenced on July 1, 2001, provides life insurance protection, lump sum survival benefit and pension to those who were between the age of 18–50 years- functions on group-basis with minimum of 20 members. No new lives are added even under existing schemes at the time of renewal. Gram Panchayat acts as the nodal agency and with the help of NGO/SHG or any

other agency which identify the agricultural workers.

(v) *Farm Income Insurance Scheme:* The Scheme[51] commenced in January 2004 for providing insurance safeguards and economic security to farmers- run by the Ministry of Agriculture and Indian Agriculture Insurance Company Ltd. jointly:

- Provides ***'broader risk insurance'***
- Conceived to provide income protection to the farmers by integrating the mechanism of *insuring production* as well as *market risks*
- Farmer's income is protected by ensuring minimum guaranteed income.
- Subsidy in premium payment.
- Available for all the States and compulsory for farmers availing crop loans.

NAIS will be withdrawn for the crops covered under it but would continue to be applicable for other crops.

(vi) *Varsha Bima (Rainfall Insurance Scheme):* Introduced in 2004 south-west monsoon period – ***covers*** all natural rainfal risks and provides[52] five different options suiting varied requirements of the farming community:

- Seasonal rainfall insurance based on aggregated rainfall from June to September
- Sowing failure insurance based on rainfall between June 15 and August 15
- Rainfall distribution insurance with the weightage assigned to different weeks between June and September
- Agronomic Index constructed on the basis of water requirements of crops
- A catastrophe option covering extremely adverse deviation of 50 per cent and above in rainfall during the season

This scheme ***covers*** all natural Rainfal risks at the following stages:

- Failure of seed crop either in full or in part due to natural risk
- Loss in expected raw seed yield
- Loss of seed crop after harvest
- At seed certification stage

EXTENSION SERVICES

The Support to State Extension Programmes for Extension Reforms Scheme was launched in 2005-06, aiming at making the extension system farmer driven as well as accountable to farmers by providing for new institutional arrangements for technology dissemination. This has been done through setting up of Agricultural Technology Management Agencies (ATMA) at district level to operationalise the extension reforms. The ATMA has active participation of farmers/farmer groups, nongovernment organisations (NGOs) and other stakeholders operating at district level and below. Gender concerns are being mainstreamed by mandating that 30 per cent of resources on programmes and activities are utilised by women farmers and women extension functionaries.

Certain **other schemes**[53] which support agriculture sector are:

- ***Mass media support*** to agriculture focusing on Doordarshan infrastructure and All India Radio (AIR) broadcasting agriculture-related information;
- ***Kisan Call Centres*** (KCC) to provide agricultural information to the farming community through toll free telephone lines;
- ***Agri-clinic*** and ***agribusiness*** centres by agriculture graduates to provide extension services to farmers on payment basis through setting up of economically viable self–employment ventures, and information dissemination through agri fairs;
- ***Extension education institutes*** at *Nilokher* (Haryana), *Rajendra Nagar* (Andhra Pradesh), *Anand* (Gujarat), and *Jorhat* (Assam) are operating at regional level to improve the skills and professional competence of extension field functionaries of agriculture and allied departments;
- There are ***model training courses*** on thrust areas of agriculture, horticulture, animal husbandry, and fisheries with the objective of improving the professional competence, upgrading the knowledge, and developing technical skills of subject matter specialists/extension workers of agriculture and allied departments; and
- ***MANAGE*,** Hyderabad, an apex Institute at the national level, provides training to middle and senior level officers of agriculture and allied departments of the states/UTs[54].

NATIONAL MISSION FOR SUSTAINABLE AGRICULTURE (NMSA)

The NMSA, launched in 2011-12, **aims** at enhancing food security and protection of resources such as land, water, biodiversity, and genetic resources by developing strategies to make Indian agriculture more resilient to climate change[55]. The ***Economic Survey 2011-12*** discusses the *Impacts of Climate Change on Indian Agriculture* in the following points:

- Indian agriculture, with two-third rainfed area remains vulnerable to various vagaries of monsoon, besides facing occurrence of drought and flood in many parts of the country. Natural calamities such as drought and flood occur frequently in many parts of the country.
- Climate change will aggravate these risks and may considerably affect food security through direct and indirect effects on crops, soils, livestock, fisheries, and pests. Building climate resilience, therefore, is critical.
- Potential adaptation **strategies** to deal with the adverse impacts of climate change are –
  (i) Developing cultivars tolerant to heat, moisture, and salinity stresses;
  (ii) Modifying crop management practices; improving water management;
  (iii) Adopting new farm practices such as resource-conserving technologies;
  (iv) Crop diversification; improving pest management;
  (v) Making available timely weather-based advisories;
  (vi) Crop insurance; and harnessing the indigenous technical knowledge of farmers.

The Indian Council of Agricultural Research has initiated a scheme on *National Initiative on Climate Resilient Agriculture (NICRA)*. The initiative has been planned as a multi-disciplinary, multi-institutional effort covering crops, livestock, and fisheries and focusing mainly on adaptation and mitigation of climate change in agriculture. It also has a component for demonstration of climate-coping technologies on farmers' fields in 100 most vulnerable districts. State-of-the-art infrastructure is being set up at key research institutes to undertake frontier research on climate change adaptation and mitigation.

SECOND GREEN REVOUTION

Use of all eco-friendly means in cultivation is the Second Green Revolution or Evergreen Revoultion or Sustainable Agriculture. For experts[56] it includes the agricultural practices such as,

(i) replacing chemical fertilisers by bio-fertilisers;

(ii) in place of chemical pesticides using bio-pesticides;

(iii) conserving water, balanced cropping pattern, proper crop combinations, etc;

Such agricultural practices are popular in developed economies as *organic farming.*[57]

Second Green Revolution in India

The Second Green Revolution in India is *a concept* as well as the name of *a programme*. It was suggested as an idea of sustainable agriculture in mid-1990s by the agro-scientists as the ongoing GR was not based on sustainable agricultural practices. When the Indian President, Dr. Kalam suggested for the same he attached much wider meaning to it. For him it consisted, crop management, cost reduction, value addition, processing and marketing other than the green farming.

In January 2004, the Government of India announced a major agricultural programme named as the Second Green Revolution with an initial fund allocation of '50,000 crore. This programme was so exhaustive that it had hardly left any problem area of Indian agriculture untouched and had every potential of solving all long-standing problems. In a sense it was a complete agricultural policy based on the concept of sustainable development and well-equipped to fight the challenges posed by the WTO and capable enough to make Indian agriculture to emerge as a winner in the globalising economy. As there was a government change at the centre, the complete details of the programme were not made available. The present government at the centre has not been referring to this programme but in practice it looks like promoting the same causes more vigorously. In the meantime the President has been quoting the need for a second green revolution time and again.

Summing up the Second Green Revolution

If we add up the ***different announcements*** by the governments time to time and the ***propositions of experts*** we may sum up the idea of the second green revolution in India with the help of its three broad coordinates:

1. *Increasing Agricultural Production:* It includes four major things—

(a) Unlike the Green Revolution which was limited to only five foodgrains (wheat, rice, jowar, bajra, maize), the Second Green Revolution includes all agricultural products—cereals, cash crops, animal husbandry (dairy, goatry , piggery, poultry, etc.), fisheries, sericulture, etc. It is rightly called the ***Rainbow Revolution***, Naturally, it is the most ambitious idea in agriculture sector of India ever formalised.

(b) It deals with suitable kinds of cropping pattern, crop diversification, crop management, plant protection, checking per-harvest losses of agriculture products as well as post-harvest, integrated pest management, soil conservation, etc.

(c) Initiation of sustainable practices in agriculture are all instrumental factors of sustainable agriculture to be utilised.

(d) One very important point should be noted here that India cannot afford to go for only green farming or organic farming in the name of sustainable agricultural development. As the replacement of chemical inputs by the organic ones has every chance of reducing production and with use of costlier inputs, the produce of such a farming will not be economically accessible by the vast poor population of India (already due to costlier outputs, of the GR masses lack the required purchasing capacity). That is why ***'cost cut'*** is an integral part of this revolution. And that is why agro-scientists have suggested to base our agriculture on ***biotechnology***. Use of biotechnology in agriculture does not only open new dimensions for it but it has every potential to cut costs of the agricultural products by doing miraculous and unthinkable kind of research and development. India is very much aware of this reality that without an active support of biotechnology, sustainable agricultural development will have only elitist value and nothing else.[58]

2. *Value Addition:* Indian agriculture has been lacking the aspect of value addition. In Indian agriculture sector right from farmers to the traders there has been a tendency of deposing agricultural goods in its primary form. That is why the real potential of Indian agriculture to create gainful employment has never been tapped. This green revolution tries to go for it in a big way. In this direction there will be an increased emphasis upon agro-processing, beverages and drinks industries.

3. *Strengthening the Infrastructural/Institutional Aspects:* The last coordinate of the Second Green Revolution is related to the aspects of timely and adequate infrastructural/institutional support without which it cannot happen:

(a) We need to strenghen the ***credit delivery*** aspects for the agriculture sector—both at micro level and at macro level (for corporate farming).

(b) The ***storage facilities*** for agricultural products in India is among the weakest in the world. India does not have adequate capacity of dry godowns and cold storage. In the area of refrigerated storage, much needs to be done. A beginning has been made recently by the Railways with the initiation of the refrigerated station wagons. Basically, private sector participation is considered very vital for the growth of this segment.

(c) The country lacks a suitable kind of ***transport connectivity*** for which super-highways and rural connectivity programmes are today the high priority areas for the government. The private sector is also being encouraged though at present it too seems to have a limited role in this area especially in urban areas and at micro level only.

(d) The development of ***telecommunication*** with all modern means are necessary pre-conditions for the timely development of agriculture sector and for the empowerment of the farmer.

(e) The ***irrigation preparedness*** of India needs grassroot level approach (already part of the Bharat Nirman) and needs a foolproof systemic approach. It becomes specially important once the climate has started showing its vagaries more and more in recent times.

(f) Everything done till date in the area of developing an adequate kind of ***marketing network*** for agricultural products has not been capable of delivering the same. And that is why the profession of agriculture has been failing to emerge as an economic and profitable area for the farmers. We need to restructure and strengthen it right from the grassroot level to the national level. Only then can we internationalise (***globalise***) our agriculture sector.

(g) If there has been any one area which has failed to have the proper care and support of the insurance it has been the agriculture sector. Even after covering all agricultural activities and products under the agricultural insurance scheme (The *National Agricultural Insurance Scheme*, 1999) it has very low penetration basically due to lack of awareness among the farmers/beneficiaries. Now the government is trying hard to do the same which also depends upon suitable level of insurance sector reforms, state governments, care to the sector and awareness among the beneficiaries. At present India has insurance coverage for the crops, seeds. Now there is a proposal to cover even the marketing risk, too.

If we make some **statements** about the SGR, there must not seem any exaggeration in it:

- “The SGR is capable of solving the whole gamut of problems related to Indian food philosophy.”
- “The SGR will give agriculture & rural development the due it deserves.”
- “The SGR will make Indian agriculture face the challenges of the WTO and emerge as a net gainer in the process of globalisation.”
- “The SGR is the best route to make economic reforms reach the masses and benefit those who consider it anti-poor, anti-agriculture and anti-rural areas.”
- “The SGR is the best way to let people feel that economic reform has a *human face* and very much essential for rich and poor, alike.”
- “The SGR is, undoubtedly the best and the ultimate as well as a complete agriculture policy of India.”

In recent times, the governmental approach has gone for a complete change in favour of agriculture sector and the SGR. It is clearly visible from the streamlining of the New Agricultural Policy (2000), the Union Budget, Foreign Trade Policy, the Credit and Monetary Policy what would be the future requirements of the SGR.

Impact of Second Green Revolution

The Second Green Revolution has every prospect of revolutionising the agriculture sector of India with multi-dimensional positive impact on agriculture in particular and the economy, in general:

1. As agricultural production will increase, India will be safe from ***food security*** concern. This will provide India ***physical access*** to food.

2. Every Indian will have ***economic access*** to food because of increase in production and cost cut due to genetically modified foods (GMFs) will make food cheaper.
3. As this is a sustainable kind of agriculture revolution, India will also be able to make its agriculture sector ecologically safe—the achievement of ***ecological access*** will become possible.
4. The surplus agricultural produce will enter the world market and agriculture sector will be able to tap the ***benefits of globalisation*** thus, farmers, rural areas and agri-business will be able to feel the benefits of economic reforms and globalisation.
5. It will create ***gainful employment*** sources in the agriculture sector on which more than 58 per cent of the population depends for its livelihood. It will serve the purposes of poverty alleviation, bridging economic inequality, boosting rural development, solving the curse of unemployment, etc.
6. It will eliminate hunger and malnutrition from India.
7. India won't be an example of **'*market failure*'**—its market will succeed by increasing the purchasing capacity of the population.
8. Living standard of the population will improve and development has to show up. Thus India's rank on the human development index (HDI) will improve for sure.

Other than the above-given points, there will be numerous related positive effects on the economy as a whole and on the agriculture sector in particular.

Second Green Revolution Strategy Adopted in Eleventh Plan[59]

The urgent need for taking agriculture to a higher trajectory of four per cent annual growth can be met only with improvement in the scale as well as quality of agricultural reforms undertaken by the various States and agencies at the various levels. These reforms must aim at efficient use of resources and conservation of soil, water and ecology on a sustainable basis, and in a holistic framework. Such a holistic framework must incorporate financing of rural infrastructure such as water, roads and power.

The approach paper to the Eleventh Five Year plan has highlighted such a holistic framework and suggested the following strategies to raise agricultural output:

(a) Doubling the rate of growth of irrigated area;
(b) Improving water management, rain water harvesting and watershed development;
(c) Reclaiming degraded land and focusing on soil quality;
(d) Bridging the knowledge gap through effective extension;
(e) Diversifying into high value outputs, fruits, vegetables, flowers, herbs and spices, medicinal plants, bamboo, bio-diesel, but with adequate measures to ensure food security;
(f) Promoting animal husbandry and fishery;
(g) Providing easy access to credit at affordable rates;
(h) Improving the incentive structure and functioning of markets; and
(i) Refocusing on land reforms issues.

National Commission on Farmers has already laid the foundation for such a framework.[60] Programme formulation as well as their implementation in the States must be based on unique regional contexts incorporating agro-climatic conditions; and availability of appropriate research and development (R&D) backed by timely and adequate extension and finance.

Second Push to Agriculture

The post-Green Revolution programme launched by the Government of Punjab in 2004, includes introduction of new technology in agriculture (green farming techniques, use of biotechnology, etc. encompassing the idea of *sustainable development*) besides crop diversification, promotion dairy and bee-keeping, floriculture, horticulture, modernising agriculture markets and value addition.[61]

WTO AND THE INDIAN AGRICULTURE: *PROSPECTS AND CHALLENGES*

With the operationalisation of the provisions of the World Trade Organisation (WTO), the process of globalisation commenced in the major parts of the world—the non-member countries, in the coming few years, also started negotiating for entry into the club. There has always been an air of confusion among the members and the non-members of the WTO in assessing the pros and cons of globalisation on the health of their economies. The sector which has created the highest number of deliberations in the WTO as well as views and counterviews has been agriculture—an area of utmost concern for the developed and the developing worlds alike. India is no exception to it better say it has been among few countries in the world spear-heading the campaign against the biased provisions of the WTO concerning agriculture.

India was skeptical about the issue even before joining the organisation but once it became a part of it, it started assessing the situation objectively and moved towards crisis mitigation. Globalisation as such opened unlimited prospects for the economies but at the same time brought several challenges, too. Yes, the challenges were different in nature for the developed and the developing countries. We need to enquire the prospects and the challenges brought by the WTO for the Indian agriculture.

Had the agriculture of the leading and politically vocal developing economies' not be of subsistence level, the course of the world would have been completely different. It is the biggest hurdle in the process of globalisation and the success of the World Trade Organisation! Yes, the process of converting the sector into industry has already started in most of the leading developing economies amidst tough resistance from the farmers, political parties and the NGOs (non-government organisations) alike.

THE PROSPECTS

The oldest and the first document regarding the impact of the implementation of the provisions of the WTO, Uruguay Round (1995–2005) was prepared jointly by the *World Bank,* the *GATT*[62] and the *OECD*[63]. According to the joint document, the WTO provisions were supposed to have the following

positive impacts on the world trade:

1. By 2005 there will be an addition of $745 billion in the world merchandise trade.[64]
2. The ***GATT Secretariat*** provided a full break-up of the above-projected trade increase in the following way:
   (i) The clothing sector to have a share of 60 per cent.
   (ii) The agricultural, forestry and fisheries products to have a share of 20 per cent.
   (iii) The processed food, beverages and drinks to have a share of 19 per cent.

It means that due to the implementation of the WTO provisions, there will be only ***one per cent*** increase in the trade of all other goods excluding the above-cited sectors. It was a highly inflated view and became a matter of debate around the world. But the areas which were projected to have very high increase in their trade were not mere projections either. Member countries went home and started going for their own studies, estimations and projections—India being no exception. We must see the assessment of India:

(i) The products which were projected to have the maximum increase in their trade, India had a traditional great export potential in them. It means the WTO has a great prospect for agriculture in store as maximum goods fell in the agriculture sector. Assuming that India's share in the world exports improves from 0.5 per cent to 1.0 per cent, and India is able to take advantage of the opportunities that are created, the trade gains may conservatively be placed at $2.7 billion extra exports per year. A more generous estimate will range from $3.5 to $7 billion worth extra exports.[65]

(ii) The NCAER (National Council for Applied Economic Research) survey of the WTO on the Indian economy is cited as the best document in this area. The survey[66] had all important things to say on this issue:
   (a) The exports of agricultural products will be boosted by the WTO accepted regime.
   (b) Only the foodgrains trade that too of wheat and rice were projected to be around $270 billion.
   (c) The survey also pointed out that almsot 80–90 per cent of the increased supply of foodgrains to the world is going to originate from only two countries China and India as they are having the scope for increasing production.
   (d) But the survey painted a very wretched picture about the preparedness of Indian agriculture sector to exploit the opportunities. It concluded China to be far far better than India is this matter.
   (e) It suggested almost every form of preparedness for the agriculture sector (its glance we may have been on the second Green Revolution in India—basically the revolution is modelled on the findings and suggestions by the survey).
   (f) Lastly, the survey ended at a high note of caution and concern that if India fails in its preparations to make agriculture come out as a winner in the WTO regime the economy will emerge as the biggest importer of the agricultural products. At the same time the cheaper agri-imports might devastate Indian agricultural structure and the import-dependence may ruin the prospects of a better life for millions of poor Indians.

(g) Even if India does not want to tap the opportunities of the globalising world it has to gear up in the agriculture sector since the world market will hardly be able to fulfill the agri-goods demands of India by 2025 AD. It means, it is only India which can meet its own agri-goods demand in the future.

There is no doubt in it that the WTO has brought problably ***the last opportunity*** to make our masses have better income and standard of living via better income coming from agriculture. But provided we go for the right kind of preparation at the right time. There are enough prospects, undoubtedly.

The Challenges[67]

If the WTO brings high prospects for the Indian agriculture, it also brings in some hard-boiled challenges in front of it. These could be seen as individual challenges of the similar economies as well as joint challenges of such economies. The ***first*** category of challenges pertains to the area of relavent preparations, investment and restructuring of the agriculture. And the ***second*** category of challenges are nothing less than a revision in the very agricultural provisions of the WTO itself (around which today revolves the success and faliure of the organisation itself!). We may take a look at the challenges before the Indian agriculture:

(i) *Self-sufficiency of food:* Due to inflow of cheaper foodgrains from the world it would not remain economically viable in India to produce them and farmers might incline in favour of the profitable agri-products. This will make India heavily dependent upon the world market for its food supplies marring its achievement of food self-sufficiency. This will have serious political and ethical outcomes for India[68].

(ii) *Price Stability:* Dependence on the world market for the supply of agricultural products and specially for foodgrains will never be safe for India. As the international market for the products is highly speculative and full of variations (due to natural factors) the price stability will be always in danger—fluctuations hamper the producers and consumers of the agri-goods in India. It would be very tough fighting *dumping* of the surplus agri-goods from other countries.

(iii) *Cropping Pattern:* The cropping pattern of agriculture might take a very imbalanced shape which will be highly detrimental to the ecology at large[69] as the farmers will be always in favour of going for the crops and commodities which have comparative price advantage.

(iv) *Weaker Sections:* The benefits of globalisation may not be neutral to areas, crops and the people. There will never prevail a certainty as to which area/region or crops or the people are going to benefit from, globalisation in which year. At the same time globalisation is a process where profits can be made but it is a market-based concept. Those who are unable to produce due to lack of capital, investment and entrepreneurship will have no gains from it. They will be net consumers or buyers. Since India has a vast population of the weaker sections (as other third world countries have) this population will neither be able to increase its income nor able to purchase the agri-goods having no price stability.

It means that the weaker sections of India might miss this chance of growth and development. We need to make the benefits of globalisation reach these people, too. This could be done by a timely and society-orientied public policy which is a big challenge[70].

(v) *WTO Commitments:* There are certain time- bound obligatory commitments of India towards the provisions of WTO in the area of agriculture which are highly detrimental to the people and the economy. We may see this challenge from two angles—

(a) According to the agricultural provisions, the total subsidies forwarded by the government to the sector must not cross 10 per cent of the total agricultural outputs. At the same time, exemptions to farmers are to be withdrawn—hampering the Public Distribution System badly. India's subsidies are still far below this limit but pose a threat to the sovereign decision of need to be increased.

(b) The subsidies (with different names) to agriculture which are forwarded by the developed countries are highly detrimental to Indian agriculture and they are very high, too[71].

None of the above-given challenges are easy to fight. These are not to be fought by India only but almost all developing countries are to face it. Once the WTO comes into operation, many experts from India and abroad have provided ways to fight these challenges which may be summed up in the following way—

(i) To fight the challenges related to self-sufficiency in food, the price stability and the cropping pattern a judicious mix of suitable kind of agricultural policy and the trade policy will be the need of the hour. To the extent agricultural policy is concerned, India has a limited level of freedom. But the WTO regime does not allow the member countries to impose higher tarrif or tarrif itself to ward off cheaper agri-goods from entering the economy—this is the main reason behind the above challenges. It means it is essential to modify, change or revise the provisions of the WTO.

Similarly, the issue of agricultural subsidies (*the Boxes*) need to be equitably defined so that they do not look biased. Here also the provisions of the WTO need revision.

To fight out this typical challenge experts suggested that the ***WTO is not God-given***. Its provisions may go in for change if concerted efforts are made by the member countries in this direction. Like-minded nations who face the same kind of crises should come together and go for a joint effort, from inside the WTO, for the revisions or relaxations in its provisions. Morality related and ethical issues might be used as eye-openers and a handy tool to have the attention of the developed nations and the WTO alike.

Prima facie this suggestion looked as a preach easier said than done. But post-1995 times saw a polarisation of like-minded countries inside the WTO that finally culminated into failure of the ***Seatle Round*** of the WTO deliberations. The most powerful country in the world failed to convene a meeting that too in its most distant region (the Alaska!)—a moral triumph of the poor over the rich. This incidence while indicating a possible failure of the WTO itself, boosted the morale of the developing countries to go for stronger groupings and even sub groupings under the WTO.

After the Doha Round the USA had hinted to forget multilateralism and indicated its intentions towards bilateralism. The European Union had the same intentions but it did not show it as openly as the USA. The year 2002 came as a watershed period for the WTO when the EU in its new diplomatic move announced to hear the agriculture-related issues of the developing nations. The USA announced the intentions few days after the EU announcement—just few days before the ***Cancun Meet*** of the

WTO. The Hongkong deliberation of the WTO, though it did not give anything concrete to the develolping world, provided enough hope, there is no doubt in it. The real picture emerges in the next meet for which the different pressure groups had serious meets and deliberations on their alternatives of bargaining power.

(ii) The second level suggestion to India was in the area of its preparedness for the WTO regime. India was required to set new and internationally best standards in the area of production by boosting the areas such as—research and development, biotechnology, information technology, health and phytosanitary matters. This will make Indian goods and services compete in the international market[72].

WTO AND AGRICULTURAL SUBSIDIES[73]

AMS

The subsidies provided by the government to the agricultural sector (i.e. domestic support) is termed by the WTO as Aggregate Measure of Support (AMS)[74]. It is calculated in terms of *product* and *input* subsidies. The WTO argues that the product subsidies like minimum support prices and input subsidies (non-product) like credit, fertilisers, irrigation and power will cut the production cost of farming and will give undue advantage to such countries in their access to world market—such subsidies are called to cause ***'distortions'*** to the world trade. Such subsidies are not permitted in one sense as they have a minimum permissible limit *de minimis* under the provisions which is 5 per cent and 10 per cent of their total agricultural output in the case of developed and developing countries, respectively.

The Boxes

The agricultural subsidies, in the WTO terminology have in general been identified by 'boxes' which have been given the colours of the traffic lights—*green* (means permitted), *amber* (means slow down i.e. to be reduced) and *red* (means forbidden).

In the agriculture sector, as usual, things are more complicated. The WTO provisions on agriculture has nothing like *red box* subsidies, although subsidies exceeding the reduction commitment levels is prohibited in the *'amber box'*. The *'blue box'* subsidies are tied to programmes that limit the level of production. There is also a provision of some exemptions for the developing countries sometimes called the 'S & D box'.[75]

We may see them individually though they are very much connected in their applied form. The objective meaning of each one of them becomes clear, once one has gone through all of them:

Amber Box

All subsidies which are supposed to distort production and trade fall into the amber box, i.e., all agricultural subsidies except those which fall into the blue and green boxes.[76] These include government policies of ***minimum support prices*** (as MSP in India) for agricultural products or any

help directly related to production quantities (as power, fertilisers, pesticides, irrigation, etc).

Under the WTO provisions, these subsidies are subject to reduction commitment to their minimum level—to 5 per cent and 10 per cent for the developed and the developing countries, respectively, of their total value of agricultural outputs, per annum accordingly. It means, the subsidies ***directly related*** to production promotion above the allowed level (which fall in either blue box or green box) must be reduced by the countries to the prescribed levels.

In the current negotiations, various proposals deal with issues like deciding the amount by which such subsidies should be reduced further, and whether to set product-specific subsidies or to continue with the present practice of the *'aggregate'* method.

Blue Box

This is the *amber box with conditions*. The conditions are designed to reduce distortions. Any subsidy that would normally be in the amber box, is placed in the blue box if it requires farmers to go for a certain production level.[77] These subsidies are nothing but certain direct payments (i.e. direct set-aside payments) made to farmers by the government in the form of assistance programmes to encourage agriculture, rural development, etc.

At present there are no limits on spending on the blue box subsidies. In the current negotiations, some countries want to keep blue box as it is because they see it as a crucial means of moving away from distorting the amber box subsidies without causing too much hardship. Others want to set limits or reduction commitments on it while some advocate moving these subsidies into the amber box.

Green Box

The agricultural subsidies which cause minimal or no distortions to trade are put under the green box.[78] They must not involve price support.

This box basically includes all forms of government expenses which are not targeted at a particular product and all direct income support programmes to farmers which are not related to current levels of production or prices. This is a ***very wide box*** and includes all government subsidies like—public storage for food security, pest and disease control, research and extension, and some direct payments to farmers that do not stimulate production like restructuring of agriculture, environmental protection, regional development, crop and income insurance, etc.

The green box subsidies are allowed without limits provided they comply with the policy-specific criteria.[79] It means, this box is exempt from the calculation under subsidies under the WTO provisions because the subsidies under it are not meant to promote production thus do not distort trade. That is why this box is called *'production-neutral box'*. But the facts tell a different story[80].

In the current negotiations, some countries argue that some of the subsidies forwarded under this box (by the developed economies) do serious distortion to trade (opposed to the view of minimal distortion as used by the Annexure 2) it is the view of the developing countries. These countries have raised their fingers on the direct payments[81] given by the developed countries to their farmers via programmes like income insurance and income-safety schemes,[82] environmental protection,[83] etc. Some other countries take the opposite view and argue that the current criteria are adequate, and

advocate to make it more flexible (so that it could be increased) to take better care of non-trade concerns such as environmental protection and animal welfare.

S&D Box

Other than the above-discussed highly controversial boxes of agricultural subsidies, the WTO provisions have defined yet another box i.e., the S & D Box. The Social and Development Box (S & D Box) allows the developing countries for some subsidies to the agriculture sector under certain conditions. These conditions revolve around ***human development issues*** such as poverty, minimum social welfare, health support etc., specially for the segment of population living below the poverty line. Developing countries can forward such subsidies to the extent of less than 5 per cent of their total agricultural output.[84]

Export Subsidies

For export subsidy the WTO has provisions in two categories—

(i) Reduction in the total budgetary support on export subsidies, and

(ii) Reduction in the total quantity of exports covered by the subsidy.

Higher reduction commitment for the developed countries and lower for the developing countries are the provisions. But the developed nations forward such an inflated support to their agricultural exports that even after the committed reductions it will be highly price distorting against the agri-exports of the developing countries. It is therefore opposed by the developing countries.

Sanitary and Phytosanitary Measures

The provisions of the WTO allow member countries to set their own health and safety standards provided they are justified on scientific grounds and do not result in arbitrary or unjustified barrier to trade. The provisions encourage use of international standards and also include certain special and differential treatment in favour of the developing countries.[85]

Though this provision has realised the scope of unjustified kind of health and phytosanitory measures on the developing countries, the developed nations have been beautifully able to do so by validating their health and related rules on scientific grounds. Such instances have distorted the trade in favour of these countries and the developing countries' agriculture has been the real loser. The developing countries accuse such measures as the non-tarrif barriers used by the developed nations to block goods from the developing nations.

NAMA

The Non-Agricultural Products Market Access (NAMA) is a part of the WTO provisions which deals with the idea of encouraging market reach to the non-agricultural goods of the member countries.[86] But the encouragement was objected/opposed by the developing countries specially pointing to the non-tariff barriers enforced by the developed countries. At the Doha Ministerial Conference (November 2001) ministers agreed to start negotiations to further liberalise trade of non-agricultural

products. By early 2002, a Negotiating Group on NAMA was created. The members at the meet decided to go for tariff reductions on non-agricultural products adopting the **Swiss Formula.** The negotiations are still in the process—updated position may be seen in detail in Chapter 19.

One major concern the members took note was of the small and vulnerable economies for whom a flexibility was committed while going for tariff reductions. For India, market access is not an issue of tariffs alone but it means elimination of tariff peaks and tariff escalation in the markets of the developed countries. It will also end the abuse of anti-dumping laws and remove non-tariff barriers (NTBs) used to block goods from developing countries.

Swiss Formula

A variety of alternative methods are possible in the process of tariff reductions—some are more common than others. Some are based on *formulas*. But one thing should be kept in mind that whatever formula be agreed upon it does not have value unless it is properly implemented. Even after a formula or combination of formulas has been agreed upon, the final outcome of tariff reductions may depend on the bargaining capacity between countries.

The **Swiss Formula**[87] belongs to the classification of formulas known as having harmonising impact. Since such a formula prescribes a higher/steeper cut on higher tariffs and lower cuts on lower tariffs it is seen to harmonise the rates by bringing the final rates becoming closer and bridging the gap.

The formula was proposed by Switzerland in the Tokyo round negotiations of GATT (1973–79). But Switzerland opposes using this method in the current agriculture negotiations—it prefers the **Uruguay Round Formula.**

The Uruguay Round (1986–94) negotiations in agriculture produced an agreement for developed countries to cut tariffs on agricultural products by an average of 36 per cent over six years (6 per cent per year) with a minimum tariff cut of 15 per cent on each product for the period. It was a version of *flat rate* method of tariff reductions.[88]

ECONOMIC SURVEY 2012-13 ON AGRICULTURE

Comments and advisory inputs from the latest document may be summarised as follows –

- India's foodgrains production has shown remarkable improvement in recent years. The production of food-grains in 2011-12 was at a record high of **259.32** million tonnes. This achievement comes at a time when it is generally recognized that inadequate attention to agriculture across many parts of the world led to food shortages and steep hikes in food prices. In comparison, Indian agriculture has performed well primarily due to timely policy interventions. Nevertheless, the average annual growth rate of **3.6** per cent during the 11th Plan for the agriculture & allied sector fell short of the target of **4** per cent. Moreover the country faces the stiff challenge of feeding its growing population.
- A number of ***constraints*** and ***challenges*** remain to be addressed – the country will have to invest heavily in *farm research, rural infrastructure, providing better access to high value*

markets, better credit facilities and *input use,* so that the farming community as a whole is motivated to produce more and the target of 4 per cent growth set for the agriculture and allied sector in the 12th Plan is met.

- Though India is one of the leading producers in the world of many major crops like paddy, wheat, pulses, sugarcane, spices, and plantation crops, the comparison in terms of ***yield*** levels is not creditable with it achieving a much lower rank in many of these crops – studies indicate that there are wide yield gaps among various crops across the country. Agriculture production can be substantially increased India addresses this yield gap by adopting *technological* and *policy* interventions. Improvement in yields holds the key for India to remain self-sufficient in foodgrains and also make a place for itself in many agricultural crops and products in the international market.
- Maximizing *agricultural income* is among the most immediate issues of attention – while adopting a more sustainable agricultural strategy. The concerns here are land and *water degradation* due to soil erosion, *soil salinity, water logging,* and *excessive application of nutrients*. There are concerns arising also from over-exploitation of water resources, especially in the ***Green Revolution*** belt.
- Better management practices for rehabilitation of degraded land and water resources hold the key – measures must be taken to promote use of quality seeds, cultivation of drought-resistant varieties of crops, judicious use of available water, balanced use of fertilizers, farm mechanization to improve efficiency levels, and wider use of irrigation facilities. Expenditure on agricultural research also needs to be stepped up substantially.
- *Climate change* and *extreme weather* events with greater intensity and frequency can have serious implications for our agriculture sector and create greater instability in food production and thereby farmers' livelihood. The current crop insurance cater to the unavoidable climatic conditions or pest epidemics.
- Declining *per capita availability of foodgrains* has been a major concern in India. For ensuring nutritional security, it is not only important to increase per capita availability of foodgrains but also to ensure the right amounts of food items in the food basket of the common man. A thrust on horticulture products and protein-rich items is required for enhancing per capita availability of food items as well as ensuring nutritional security.
- Agricultural growth in the *eastern and north-eastern regions* has been slower than in the rest of the country – the good prospects of production in many crops in these parts of the country should quickly be taken advantage of in the years to come. Hence ***a strategy*** for agricultural development in eastern and north-eastern India comprising multiple livelihood opportunities, sustainable agricultural development through a farming systems approach, efficient national resources management, ecoregional technology missions, and rice-based farming systems needs to be put in place.
- ***Supply chain*** management in agricultural marketing is another key issue – farmers' access to markets is hampered by *poor roads, rudimentary market infrastructure,* and *excessive regulation.* Many agricultural crops are perishable in nature and post-harvest handling issues and marketing problems affect the farm incomes. It is ***necessary*** that India evolves mechanisms for linking wholesale processing, logistics and retailing with farm-production

activities so as to generate enhanced efficiency, better farm prices, etc. The *private sector* should be allowed to operate in developing these market linkages for which suitable reforms will help. Recently the government allowed *foreign direct investment (FDI) in retail*, which has been supported by many farmer organizations as well, and it can pave the way for investment in new technology and marketing of agricultural produce in India.

- There has been substantial increase in the ***MSPs*** of various crops over the last few years. Though considered necessary for incentivizing farmers, the MSP signals the floor price for the produce. There is a huge cost involved in the process, in the form of food subsidy. Further, this policy of stocking foodgrains well above the buffer norms comes under criticism on the grounds of hoarding and creating artificial shortages in the market, thereby jacking up the prices of essential commodities. Urgent attention needs to be accorded to efficient food stocks management, timely offloading of stocks, and a stable and predictable trade policy.
- Strengthening *agricultural statistics* with reliable and timely availability of *forecasts of agricultural crops is also an immediate need as the gaps in agricultural statistics will hamper agricultural development planning and policymaking.*

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1. ***Economic Survey 2012-13***, MoF, GoI, N. Delhi, p. 173; CSO, in its Feb. 2013 release, GoI, N. Delhi.
2. ***Economic Survey 2012-13***, op. cit., p. 173.
3. ***Labour Bureau,*** GoI, N. Delhi, March 2012.
4. ***Economic Survey 2011-12***, op. cit., p. 186.
5. This corelation has been pointed out by many great economists in India since 1960s for example by ***Prof. Raj Krishna (1976), S. Chakravarty (1974–79)*** and ***C. Rangarajan, 1982*** to quote some of the most important names.
6. ***Approach Paper to the Tenth Five Year Plan***, Planning Commission, GoI, N. Delhi, 2002.
7. This was the general opinion of the experts throughout 1990s but the official document which accepted this contention was the ***Foreign Trade Policy 2002-07***, Ministry of Commerce, GoI, N. Delhi. The view has been continued with by the GoI in all of its forthcoming trade policies.
8. ***Economic Survey 2012-13***, op. cit., p. 174.
9. ***Press Release***, Ministry of Agriculture, GoI, N. Delhi, May 4, 2012.
10. ***Economic Survey 2011-12***, op. cit., p. 191.
11. ***Indian Council of Agricultural Research*** (ICAR), N. Delhi, 1998.
12. ***India 2000 and Economic Survey 2000–01***, GoI, N. Delhi.
13. ***Brundtland Report*** on Sustainable Development after the deliberations at the summit ***"Our Common future",*** 1987.
14. Rudolph, L.I and S.H. Rudolph, ***In Pursuit of Lakshmi: The Political Economy of the Indian State,*** Orient Longman, Bombay, 1987, pp. 45–50.
15. This was the view of the majority of the experts around the world by the late 1960s.
16. P.S. Appu, ***Land Reforms in India: A Survey of Policy, Legislation and Implementation,*** Land Reforms Unit, Lal Bahadur Shastri National Academy of Administration, Mussouri, 1995, pp. 232–33.
17. ***India 2007,*** op. cit.
18. ***Consultative Group on International Agricultural Research*** (CGIAR), World Bank, Washington DC, 1971.
19. ***International Maize and Wheat Improvement Centre*** (CIMMYT), Mexico, 1971.
20. This made it compulsory to use highly concentrate chemical fertilisers, pushing the traditional organic fertilisers (i.e., composte) out of fashion.
21. This was the reason why the GR was implemented firstly in the rainfall deficient regions of India i.e., Haryana, Punjab and western Uttar Pradesh.

22. ***India 2002,*** Pub. Div., GoI, N. Delhi.
23. Various ***Economic Surveys,*** specially 1985–86 to 1994–86 to 1994–95, GoI, N. Delhi.
24. Based on various empirical studies in the 1990s conducted separately by ***Vandana Shiva, C.H. Hanumantha Rao, ICAR, Planning Commission, etc.***
25. ***New Agricultural Strategy,*** GoI, N. Delhi, 1966.
26. ***India–2007.***
27. ***India–2007.***
28. ***Revised Buffer Stocking Policy,*** GoI, 2006.
29. ***Economic Survey 2011–12***, op. cit, p. 197.
30. ***Economic Survey, 2011–12,*** op. cit.
31. ***Economic Survey***, 2011–12, op. cit, p. 198.
32. ***Economic Survey***, 2011-12, op. cit, p. 195.
33. ***India–2007*** & ***India-2010***
34. Rakesh Mohan, '***Agricultural Credit in India: Status, Issues and Future Agenda***', from his lecture delivered at the **17th National Conference of Agricultural Marketing**, Indian Society of Agricultural Marketing, Hyderabad, February 5, 2004 [Rakesh Mohan was the then Deputy Governor, Reserve Bank of India]
35. Known as the Unregulated Credit Market.
36. ***Economic Survey 2011-12,*** op. cit., p. 199.
37. ***Central Institute of Post-Harvest Engineering and Technology (CIPHET),*** ICAR, Ministry of Agriculture, GoI, Ludhiana, Study released in September, 2011.
38. ***Planning Commission,*** GoI, N. Deli, 1961.
39. ***Economic Survey 2011-12,*** op. cit., p. 190.
40. ***Economic Survey 2011-12,*** op. cit., p. 190.
41. ***Economic Survey 2011-12,*** op. cit., p. 190.
42. ***Economic Survey 2011-12,*** op. cit., p. 190-191.
43. ***Economic Survey 2011-12,*** op. cit., p. 191-192.
44. ***Economic Survey 2011-12,*** op. cit., p. 192.
45. ***Economic Survey 2000–01,*** MoF, GoI, N. Delhi.
46. New Agriculture Policy has been described as “Rainbow Revolution” which includes the following revolutions:

    Green (Food Grain Production), White (Milk), Yellow (Oil seeds), Blue (Fisheries), Red (Meat/Tomato), Golden (Fruits-Apple), Grey (Fertiliser), Black/Brown (Non-conventional Energy Sources), Silver (Eggs) and Round (Potato).

    The above Rainbow Revolution also includes “Food Chain Revolution” to put a check on destroying foodgrains, vegetables and fruits.
47. ***Economic Survey 2011–12,*** MoF, GoI, N. Delhi.
48. ***Economic Survey 2011–12,*** MoF, GoI, N. Delhi.
49. ***Economic Survey 2006–07,*** op. cit.
50. ***India 2010 & 2011,*** Pub. Division, N Delhi, P. 379.
51. ***Economic Survey 2004–05,*** MoF, GoI, N. Delhi.
52. ***India 2005,*** GoI, N. Delhi.
53. ***Economic Survey 1999–2000,*** op. cit.
54. ***MANAGE*** was established in 1987, as the *National Centre for Management of Agricultural Extension* at Hyderabad, by the Ministry of Agriculture, Government of India as an autonomous Institute, from which its acronym *‘MANAGE’* is derived. In recognition of its importance and expansion of activities all over the country, its status was elevated to that of a National Institute in 1992 and re-christened to its present name i.e., National Institute of Agricultural Extension Management.

    MANAGE is the Indian response to challenges of agricultural extension in a rapidly growing and diverse agriculture sector. The policies of liberalization and globalization of the economy and the level of agricultural technology becoming more sophisticated and complex, called for major initiatives towards reorientation and modernization of the agricultural extension system. Effective ways of managing the extension system needed to be evolved and extension organizations enabled to transform the existing set up

through professional guidance and training of critical manpower. MANAGE is the response to this imperative need.

55. ***Prime Minister's Council on Climate Change (PMCCC)*** approved the Mission in September 2010 and the Ministry of Agriculture initiated activities under the Mission in 2011-12.

56. As per M.S. Swaminathan, Dr. A.P.S. Abdul Klam, P.S. Paroda, ICAR, etc.

57. This kind of farming had already commenced in the Euro-American economies by the 1980s. However, the concept gained popularity by the early 1970s in the wake of environmental pollution due to rapid industrialisation. ***The Brundtland Report on Sustainable Development*** (1987) gave the ultimate boost.

58. Some of the known potential which the agro-scientists are in the process of speedier implementation are—7 to 8 times potential of increasing productivity of the foodgrains; drought and flood resistant seed development; pest-resistant seeds; hybrid seeds like ***'pomato'***; new bio-fertilisers and bio-pesticides; etc., All these new technologies initiated into the agricultural practices will not only boost the production but cut the costs enabling India to have ***economic reach*** to food being with the eco-friendly methods of farming.

    As the question of ***food security*** is a matter of immediate concern for countries like India and China, the onus of popularising the genetically modified foods (GMFs) remains on them. That is why we see these two countries allowing the use of the GMFs in recent years.

59. ***Economic Survey 2006–07,*** op. cit.

60. ***India 2007,*** (op. cit.) might be seen for details.

61. Ministry of Agriculture, Government of Punjab, June 2004, Chandigadh.

62. General Agreement on Trade and Tariff (GATT) was a multi-lateral arrangement (not an ***organisation*** like WTO whose deliberations are binding on the member countries) promoting multi-lateral world trade. Now the GATT has been replaced by the WTO (***since Jan. 1995***).

63. ***Organisation for Economic Cooperation and Development*** (OECD) was set up as a world body of the developed economies from the Euro-American region which today includes countries from Asia, too (such as Japan, S. Korea). The first idea of 'globalisation' was proposed by the OECD in the early 1980s at one of its Annual Meet (***at Brussels***).

64. Merchandise trade does not include services.

65. Economic Survey 1994–95, MoF, GoI, N. Delhi.

66. ***NCAER Survey*** headed by its chairman Rakesh Mohan, GoI, 1994.

67. The challenges and their possible remedies discussed in this sub-topic are based on some of the finest and timely debates and articles which appeared in many renowned journals and newspapers between the period 1994–2007. For better understanding of the readers only the consensual as well as the less-complex parts have been provided here.

68. Almost 50 per cent of the Indian population spends 75 per cent of its total income on the purchase of foodgrains—this is why their standard of life and nutrition depends on the indigenously grown food in a great way. Once the self-sufficiency is lost their lives will depend upon the ***diplomatic uncertainties*** of its regular supply. It will have serious political outcomes for the political scenario of India. Similarly, irregular supply of the foodgrains will create a high ethical dilemma, too.

69. Farmers might go for highly repetitive kind of cropping pattern creating problems for soil fertility, water crisis, etc. This will have highly adverse effects on the agriculture insurance companies, too.

70. The primary examples of corporate and contract farming have given enough hints that economically weaker sections of society have meagre chances of benefitting from the globalisation of agriculture—with major profits going to the corporate houses. Naturally, the governments (centre and states) will need to come up with highly effective policies which could take care of the economic interests of the masses.

    The policies may focus on areas such as ***healthcare, education, insurance, housing, social security,*** etc. Already the governments have started emphasising the delivery and performance of the ***social sector*** but in the future, more focused and accountable programmes in the sector will be required.

71. Some of the developed economies are still forwarding subsidies to the agricultural areas to the tune of 180–220 per cent! Again, the justification for such high subsidies have been provided by defining agriculture subsidies according to their ease—highly blurring and confusing.

72. Because even the agriculture related provisions are modified the global market will always run after the agri-products which are the best—pricewise, qualitywise, etc.

73. A simplified and 'easy-to-understand' analysis done on the basis of the documents of the ***Information and Media Relations Division*** of the World Trade Organisation Secretariat, Geneva, Switzerland, October, 2007.

74. Defined in ***Article 1*** and ***Annexures 3 & 4,*** Agreement on Agriculture (AoA), WTO, 1994.

75. ***Article 6.2, AoA***, WTO, 1994.
76. ***Article 6, AoA***, WTO, 1994.
77. ***Article 6***, ***Para 5*** AoA, WTO, 1994.
78. ***Annexure 2, AoA***, and ***Para 1*** AoA, WTO, 1994.
79. ***Annexure 2, AoA***, AoA, WTO, 1994.
80. Basically, a large part of this box is used by the farmers in the USA and the European Union as basic investments in agriculture. India as well as other like-minded countries have this view and want this box to be brought under the AMS i.e. under the reduction commitments. The USA at the Hongkong Ministerial meet (December 2005) announced to abolish such subsidies in the next 12 year commencing 2008. The EU also proposed to reduce its ‘trade distorting subsidies’ by 70 per cent. None of them used the name green box which shows some internal vagueness.
81. ***Para 5, Green Box, AoA,*** WTO, 1994.
82. ***Para 7, Green Box, AoA,*** WTO, 1994.
83. ***Para 8, Green Box, AoA,*** WTO, 1994.
84. ***Article 6.2, AoA,*** WTO, 1994.
85. ***Article 14, AoA,*** WTO, 1994.
86. As per the provisions of the WTO ***fishes, fisheries products*** and ***forest products*** don’t fall under agriculture and have been classified as the non-agricultural products.
87. ***“Formula Approaches to Tariff Negotiations”*** (Revised), WTO, Oct. 2007.
88. ***Uruguay Round of GATT,*** 1994.

* Economic Servey 2012-13, MoF, GOI, P.3.

9

INDIAN INDUSTRY & INFRASTRUCTURE

*In China I was greatly attracted to the Industrial Co-operatives – the Indusco movement – and it seems to me that some such movement is peculiarly suited to India. It would fit in with the Indian background, give a democratic basis to small industry, and develop the co-operative habit. It could be made to complement big industry. It must be remembered that, however rapid might be the development of heavy industry in India, a vast field will remain open to small and cottage industries. Even in Soviet Russia owner-producer co-operatives have played an important part in industrial growth.**

- Introduction
- A Review of the Industrial Policies (1948–86)
- Industrial Policy Resolution, 1956
- Industrial Policy Statement, 1969
- Industrial Policy Statement, 1973
- Industrial Policy Statement, 1977

** As Jawaharlal Nehru writes in 'The Discovery of India', Oxford University Press, 6th Impression (1st Edition 1946, Oxford, London), N Delhi, 1994, p. 406.*

- Industrial Policy Resolution, 1980
- Industrial Policy Resolution, 1985 & 1986
- Disinvestment
- Investment Challenge
- New Steps to Boost Manufacturing
- Industry & Environment
- Economic Survey 2012-13 on Industry
- Indian Infrastructure
- Energy Pricing
- Dedicated Freight Corridor
- PPP: New Steps
- State Discoms
- Economic Survey 2012-13 on Infrastructure

INTRODUCTION

Many of the western economies have already written their success stories of industrialisation leading to accelerated growth and development by the time India became an independent economy. Independent India needed to rejuvenate its economy from a completely dilapidated state. The country had many tasks in front of it—the abject mass poverty, shortage of foodgrains, healthcare, etc. calling for immediate attention. The other areas of attention included industry, infrastructure, science and technology and higher education, to name a few. All these areas of development required heavy capital investment as they had been severly avoided by the colonial ruler for the last 150 years or so. Increasing the growth of economy and that too with a faster pace was the urgent need of the economy. Looking at the pros and cons of the available options, India decided the sector industry to be the 'prime moving force' (PMF) of the economy—the logical choice for a faster growth (a fully established idea at that time, all over the world). The secondary sector will lead the economy, was well-decided in the 1930s itself by the dominant political force among the freedom fighters.

As the government of the time had decided upon an active role for the governments in the economy, naturally, the industrial sector was to have a dominant state role—the expansion of the government-owned companies (i.e the PSUs) to glorious heights. In many ways the development of the Indian economy has been the development of the government sector. Once this idea of state's role in the economy went for a radical change in the early 1990s with the process of economic reforms, the hangover or the drag of it is still visible on the economy. The industrial policies which the governments announced from time to time basically moulded the very nature and structure of the economy. Any discussion on the Indian economy must start with a survey of the industrial policies of the country. Here we have a brief review of the various industrial policies of India till date:

INDUSTRIAL POLICY RESOLUTION, 1948

Announced on April 8, 1948 this was not only the first industrial policy statement of India but it decided the model of the economic system (i.e. the mixed economy), too. Thus, it was the *first* economic policy of the country also. The major highlights of the policy are given below:

1. India will be a mixed economy[1].
2. Some of the important industries were put under the ***Central List*** such as coal, power, railways, civil aviation, arms and ammunition, defence, etc.
3. Some other industries (usually of medium category) were put under a ***State List*** such as paper, medicines, textiles, cycles, rickshaws, two-wheelers, etc.
4. Rest of the industries (not covered by either the central or the State Lists) were left open for private sector investment—with many of them having the provision of compulsory licencing.
5. Review of the policy after 10 years.

INDUSTRIAL POLICY RESOLUTION, 1956

The Government was encouraged by the impact of the industrial policy of 1948 and it was only after eight years that the new and more crystallised policies were announced for the Indian industries. The new industrial policy of 1956 had the following major provisions:

1. Reservation of Industries

A clear-cut classification of the industries (also known as the **Reservation of industries**) were affected with three schedules:

(i) Schedule A

This schedule had 17 industrial areas in which the centre was given complete monopoly. The industries set up under this provision were known as the Central Public Sector Undertakings (CPSUs) later getting popularity as the 'PSUs'. Though the number of industries were only 17, the number of the PSUs set up by the Government of India went to 254 by 1991. They included those industrial units too which were taken over by the government between 1960 to 1980 under the ***nationalisation*** drives[2] . These industries belonged to Schedules B and C (other than Schedule A).

(ii) Schedule B

There were 12 industrial areas put under this schedule in which the State governments were supposed to take up the initiatives with a more expansive follow up by the private sector. This schedule also carried the provisions of compulsory licencing. It should be noted here that neither the states nor the private sector had monopolies in these industries unlike the Schedule A which provided monopoly to the centre.[3]

(iii) Schedule C

All industrial areas left out of Schedules A and B were put under this in which the private enterprises had the provisions to set up the industries. Many of them had the provisions of licencing and have ***necessarily*** to fit into the framework of the social and economic policy of the state and were subject to control and regulation in terms of the Industries Development and Regulation (IDR) Act and other relevant legislations.[4]

The above classification of industries had an in-built bias in favour of the government-owned companies (i.e. the CPSUs) which went according to the ideas of the planning process, too. Thus, expansion of the public sector became almost a directive principle of economic policy and the PSUs did expand in the coming times.[5]

It was this industrial policy in which the then PM Pandit Jawaharlal Nehru had termed the PSUs the ***'temples of modern India',*** symbolically pointing to their importance[6]. There was a time soon after independence when the PSUs were regarded as the principal instrument for raising savings and

growth in the economy.[7] The rapid expansion of the PSUs accounted for more than half of the GDP of the economy by 1988–89.[8]

2. Provision of Licencing

One of the most important developments of independent India, the provision of compulsory licencing for industries, was cemented in this policy. All the Schedule B industries and a number of Schedule C industries came under this proivision. This provision established the so-called ***'Licence-Quota-Permit'*** regime (***raj***) in the economy.[9]

3. Expansion of the Public Sector

Expansion of the Public Sector was pledged for the accelerated industrialisation and growth in the economy—glorification of the government companies did start with this policy. The emphasis was on heavy industries.

4. Regional Disparity

To tackle the widening **regional disparity,** the policy committed to set up the upcoming PSUs in the comparatively backward and underdeveloped regions/areas in the economy[10].

5. Emphasis on Small Industries

Emphasis committed on small industries as well as the khadi and village industries.

6. Agriculture Sector

Agriculture sector was pledged as a priority.

Importance

This is considered as the most important industrial policy of India by the experts as it decided not only the industrial expansion but structured the very nature and scope of the economy till 1991 with minor modifications. All the industrial policies were nothing but minor modifications in it except the New Industrial Policy of 1991 which affected deeper and structural changes in it with which India started a wider process of the economic reforms.

INDUSTRIAL POLICY STATEMENT, 1969

This was basically a licencing policy which aimed at solving the shortcomings of the licencing policy started by the Industrial Policy of 1956. The experts and the industrialists (new comers) complained that the industrial licencing policy was serving just the opposite purpose for which it was mooted.

Inspired by the socialistic ideals and nationalistic feelings the licencing policy had the following reasons:

(i) Exploitation of resources for the development of all

(ii) Priority of resource exploitation for the industries

(iii) Price-control of the goods produced by the licenced industries

(iv) Checking concentration of economic power

(v) Channelising investment into desired direction (according to planning process)

In practice, the licencing policy was not serving the above-given purpose properly. A powerful industrial house was always able to procure fresh licences at the cost of a new budding entrepreneur. The price regulation policy via licencing was aimed at helping the public by providing cheaper goods but it indirectly served the private licenced industries ultimately (as central subsidies were given to the private companies from where it was to benefit the poor in the form of cheaper goods). Similarly, the older and well-established industrial houses were capable of creating hurdles for the newer ones with the help of different kinds of trade practices forcing the latter to agree for sell-outs and takeovers. A number of committees were set up by the government to look into the matter and suggest remedies.[11] The committees on industrial licencing policy review pointed out several shortcomings of the policy but it also accepted the useful role of industrial licencing.[12] Finally, it was in 1969 that the new industrial licencing policy was announced which affected the following major changes in the area:

(i) The Monopolistic and Restrictive Trade Practices (MRTP) Act was passed. The Act intended to regulate the trading and commercial practices of the firms and checking monopoly and concentration of economic power.

(ii) The firms with assets of ‘25 crore or more were put under obligation of taking permission from the Government of India before any expansion, greenfield venture and takeover of other firms (as per the MRTP Act). Such firms came to be known as the ***‘MRTP Companies’***. The upper limit (known as the ***‘MRTP limit’***) for such companies was revised upward to ‘50 crore in 1980 and ‘100 crore in 1985[13].

(iii) For the redressal of the prohibited and restricted practices of trade, the Government did set up a as ***MRTP Commission***.

INDUSTRIAL POLICY STATEMENT, 1973

The Industrial policy statement of 1973 introduced some new thinking into the economy with major ones being as follows:

(i) A new classificatory term i.e. ***core industries*** was created. The industries which were of fundamental importance for the development of industries were put in this category such as iron and steel, cement, coal, crude oil, oil refining and electricity. In the future, these industries will be also known as ***basic industries, infrastructure industries*** in the country.

(ii) Out of the six core industries defined by the policy, the private sector may apply for licences

for the industries which were not a part of Schedule A of the Industrial Policy, 1956 [14]. The private firms eligible to apply for such licences were supposed to have their total assets at `20 crore or more.

(iii) Some industries were put under the ***reserved list*** in which only the small or medium industries could be set up[15].

(iv) The concept of ***'joint sector'*** was developed which allowed partnership among the centre, state and the private sector while setting up some industries. The governments had the discretionary power to exit such ventures in future. Here, the government wanted to promote the private sector with state support.

(v) The Government of India had been facing the foreign exchange crunch during that time. To regulate foreign exchange the Foreign Exchange Regulation Act (FERA) was passed in 1973[16]. Experts have called it a ***'draconian'*** act which hampered the growth and modernisation of the Indian industries.

(vi) A limited permission of foreign investment was given with the Multinational Corporations (MNCs) being allowed to set up their subsidiaries in the country[17].

INDUSTRIAL POLICY STATEMENT, 1977

The industrial policy statement of 1977 was chalked out by a different political set up from the past with a different political fervour—the dominant voice in the Government was having an anti-Indira stance with an inclination towards the Gandhian-Socialistic views to the economy. We see such elements in this policy statement:

(i) Foreign investment in the ***unnecessary areas*** were prohibited (opposite to the IPS of 1973 which promoted foreign investment via technology transfer in the areas of lack of capital or technology). In practice, there was a complete 'no' to foreign investment.[18]

(ii) Emphasis on the village industries with a redefinition of the small and cottage industries.

(iii) Decentralised industrialisation was given attention with the objective of linking masses to the process of industrialisation. The District Industries Centres (DICs) were set to promote the expansion of the small and cottage industries at a mass scale.

(iv) Democratic decentralisation got emphasis and the Khadi and Village Industries were restructured.

(v) Serious attention was given on the level of production and the prices of the essential commodities of everyday use.

INDUSTRIAL POLICY RESOLUTION, 1980

The year 1980 saw the return of the same political party at the centre. The new government revised

the industrial policy of 1977 with few exceptions in the Industrial Policy Resolution, 1980. The major initiatives of the policy were as given below:

(i) Foreign investment via the technology transfer route was allowed again (similar to the provisions of the IPS, 1973).

(ii) The 'MRTP Limit' was revised upward to `50 crore to promote setting of bigger companies.

(iii) The DICs were continued with.

(iv) Industrial licencing was simplified.

(v) Overall liberal attitude followed towards the expansion of private industries.

INDUSTRIAL POLICY RESOLUTION, 1985 & 1986

The industrial policy resolutions announced by the governments in 1985 and 1986 were very much similar in nature and the latter tried to promote the initiative of the former. The main highlights of the policies are:

(i) Foreign investment was further simplified with more industrial areas being open for their entries. The dominant method of foreign investment remained as in the past i.e. ***technology transfer*** but now the equity holding of the MNCs in the Indian subsidiaries could be upto 49 per cent with the Indian partner holding the rest of the 51 per cent shares.

(ii) The *'MRTP Limit'* was revised upward to `100 crore—promoting the idea of bigger companies.

(iii) The provision of industrial licencing was simplified. Compulsory licencing now remained for 64 industries only[19].

(iv) High level attention on the sunrise industries such as telecommunication, computerisation and electronics.

(v) Modernisation and the profitability aspects of the public sector undertakings were emphasised.

(vi) Industries based on imported raw materials got a boost[20].

(vii) Under the overall regime of the FERA, some relaxations concerning the use of foreign exchange was permitted so that essential technology could be assimilated into Indian industries and international standard could be achieved.

(viii) The agriculture sector was attended with a new scientific approach with many *Technology Missions* being launched by the Government.

These industrial policies were mooted out by the Government when the developed world was pushing for the formation of the WTO and a new world economic order looked like a reality. Once the world had become one market, only bigger industrial firms could have managed to cater to such a big market. Side by side sorting out the historical hurdles to industrial expansion perpetuated by the past industrial policies, these new industrial policy resolutions were basically a preparation for the *globalised* future world.

These industrial provisions were attempted at liberalising the economy without any slogan of 'economic reforms'. The government of the time had the mood and willingness of going for the kind of economic reforms which India pursued post-1991 but it lacked the required political support[21].

The industrial policies conjoined with the overall micro-economic policy followed by the Government had one major loophole that it was more dependent on foreign capital with a big part being costlier ones. Once the economy could not meet industrial performance, it became tough for India to service the external borrowings—the external events (the Gulf War, 1990–91) vitiated the situation, too. Finally, by the end of 1980s India was in the grip of a severe balance of payment crisis with higher rate of inflation (over 13 per cent) and higher fiscal deficit (over 8 per cent).[22] The deep crisis put the economy in a financial crunch which made India opt for a new way of economic management in the coming times.

New Industrial Policy, 1991

India was faced with a severe balance of payment crisis in June 1991. Basically, in 1990 and 1991, there were several inter-connected events which were growing unfavourable for the Indian economy.

(i) Due to the Gulf War (1990–91), the higher oil prices were fastly[23] depleting India's foreign reserves.

(ii) Sharp decline in the private remittances from the overseas Indian workers in the wake of the Gulf War[24], specially from the Gulf region.

(iii) Inflation peaking at nearly 17 per cent.[25]

(iv) The gross fiscal deficit of the central government reaching 8.4 per cent of the GDP.[26]

(v) By the month of June 1991, India's foreign exchange had declined to just ***two weeks*** of import coverage.[27]

India's near miss with a serious balance of payments crisis was the proximate cause that started India's market liberalisation measures in 1991 followed by a gradualist approach[28]. As the reforms were induced by the crisis of the BoP, the initial phase focussed on macroeconomic stabilisation while tfhe reforms of industrial policy, trade and exchange rate policies, foreign investment policy, financial and tax reforms as well as public sector reforms did also follow soon.

The financial support India recieved from the IMF to fight out the BoP crisis of 1990–91 were having a tag of conditions to be fulfilled by India. These IMF conditionalities required the Indian economy to go for a structural re-adjustment. As the nature and scope of economy were moulded by the various industrial policies India did follow till date, any desired change in the economic structure had to be induced with the help of another industrial policy. The new industrial policy, announced by the Government on July 23, 1991 had initiated a bigger process of economic reforms in the country, seriously motivated towards the structural readjustment naturally obliged to 'fulfill' IMF conditionalities[29]. The major highlights of the policy are as follows:

1. De-reservation of the Industries

The industries which were reserved for the Central government by the IPR, 1956 were cut down to only eight. In coming years many other industries were also opened for private sector investment. At

present there are only three industries which are fully or partially reserved for the central government:

(i) Nuclear energy (at present the central government is seriously considering the proposal of allowing the private sector to enter into the management of the nuclear power plants in the country.).

(ii) Nuclear research and related activities i.e. mining, use, management, fuel fabrication, export-import, waste management, etc. of radioactive minerals (none of the nuclear powers in the world have allowed the entry to private sector in these activities, thus no such attempts look logical in India, too).

(iii) Railways (many of the functions related to the railways have been allowed private entry, but still the private sector cannot enter the sector as a full-fledged railway service provider).

2. De-licencing of the Industries

The number of industries put under the compulsory provision of licencing (belonging to schedules B and C as per the IPR, 1956) were cut down to only 18. Reforms regarding the area were further followed and presently there are only ***six industries***[30] which carry the burden of compulsory licencing:

(i) Aero-space and defence related electronics

(ii) Gun powder, industrial explosives and detonating fuse

(iii) Dangerous chemicals

(iv) Tobacco, cigarette and related products

(v) Alcoholic drinks

(vi) Drugs and Pharmaceuticals.

3. Abolition of the MRTP Limit

The MRTP limit was Rs. 100 crore so that the mergers, acquisitions and takeovers of the industries could become possible. In 2002, a Competition Act was passed which has replaced the MRTP Act. In place of the MRTP Commission, the Competition Commission has started functioning (though there are still some hitches regarding the compositional form of the latter and its real functions and jurisdictions).

4. Promotion to Foreign Investment

Functioning as a typical closed economy, the Indian economy had never shown any good faith towards foreign capital. The new industrial policy was a pathbreaking step in this regard. Not only the draconian FERA was committed to be diluted but the government went to encourage foreign investment (FI) in its both forms—direct and indirect. The direct form of FI was called as the foreign direct investment (FDI) under which the MNCs were allowed to set up their firms in India in the different sectors varying from 26 per cent to 100 per cent ownership with them—***Enron*** and ***Coke*** being the flag-bearers. The FDI started in the year 1991 itself. The indirect form of foreign investment

(i.e in the assets owned by the Indian firms in equity capital) was called the ***portfolio investment scheme*** (PIS) in the country which formally commenced in 1994.[31] Under the PIS the ***foreign institutional investors*** (FIIs) having good track record are allowed to invest in the Indian security/stock market. The FIIs need to register themselves as a stock broker with the SEBI. It means India has not allowed ***individual foreign investment*** in the security market still, only ***institutional investment*** has been allowed till now.[32]

5. FERA Replaced by FEMA

The government committed in 1991 to itself to replace the draconian FERA with a highly liberal FEMA which cause into effected in the year 2000–01 with a sun-set clause of two years.[33]

6. Location of Industries

Related provisions were simplified by the policy which was highly cumbersome and a time-consuming process. Now, the industries were classified into 'polluting' and 'non-polluting' categories and a highly simple provision deciding their location was announced:

(i) Non-polluting industries might be set up anywhere.

(ii) Polluting industries to be set up at least 25 kms away from the million cities.

7. Compulsion of Phased -production Abolished

With the compulsion of phased-production abolished, now the private firms could go for producing as many goods and models simultaneously[34]. Now the capacity and capital of industries could be utilised to their optimum level.

8. Compulsion to Convert Loans into Shares Abolished

The policy of nationalisation started by the Government of India in the late 1960s was based on the sound logic of ***greater public benefit*** and had its origin in the idea of ***welfare state***—it was criticised by the victims and the experts alike. In the early 1970s, the GoI came with a new idea of it. The major banks of the country were now fully nationalised (14 in number by that time) which had to mobilise resources for the purpose of planned development of India. The private companies who had borrowed capital from these banks (when the banks were privately owned) now wanted their loans to be paid back. The government came with a novel provision for the companies who were unable to repay their loans (most of them were like it)—they could opt to convert their loan amounts into equity shares and hand them over to the banks. The private companies which opted this route (this was a compulsory option) ultimately became a government-owned company as the banks were owned by the GoI—this was an ***indirect*** route to nationalise private firms. Such a compulsion which hampered the growth and development of the Indian industries was withdrawn by the government in 1991.[35]

The picture presented by the New Industrial policy of 1991 was taken by many experts, the opposition in the parliament and even the public figures as well as the business and industry of the country as a ***'rolling back'*** of the state. The glorious role given to the state by the Nehruvian economy

seemed completely toppled down. Any one idea the new policy challenged was an emphatic good bye to the 'control regime' perpetuated till now by the government. There was a coalition of interests of politicians, bureaucrats, multinationals as well as the domestic industrial and business houses whose interests the control regime sheltered and served.[36] Thus, a memorandum to the Government requesting not to dismantle the control regime by the major industrial houses of India as well as arrival of the '*Swadeshi Jagaran Manch*' were not illogical. But the governments continued with the reform programme with politically permissible pace and a time came when the same industrial houses requested the Government (2002) to expedite the process of reform! Now the Indian industry and business class has been able to understand the economics of 'openness' and a different kind of the mixed economy. But the process of reforms have still to go miles before its real benefits start reaching the masses and development together with reform could be made a mass movement.

This is why the experts have suggested that only assuming that reforms will benefit the masses will not be enough to make it politically happen, but the governments, the administrative agencies and the economists all need to link it positively to ***mass welfare***—it might require to create a popular climate and form the political coalitions in favour of the argument that privatisation and accordingly restructured labour laws are basically aimed at creating jobs, better job prospects, alleviating poverty, enriching education and providing healthcare to the masses[37]. In the coming times, the Government went from one to another generations of the reforms setting new targets and every time trying to make reforms sociopolitically possible.

Reforms with the human face' was one such attempt of the United Progressive Alliance in 2003 when it formed the government at the Centre. It was believed that the 'India Shining' slogan of the outgoing government (i.e. the NDA) was correct but remained localised in its effects to the urban middle class only.[38] The new government seemed taking lessons from the past and tried to make India shine for the rural masses, too. Its one programme, the ***Bharat Nirman*** (a rural infrastructure focused programme), could be seen as a political attempt to make it happen.[39]

Only the coming times will tell as to what extent the Government has been able to educate the masses (better say the voters who vote!) the needful logic of the reforms.

DISINVESTMENT

Disinvestment is a process of selling government equities in public sector enterprises. Disinvestment in India is seen connected to three major inter-related areas, namely—

(i) A tool of public sector reforms[40]

(ii) A part of the economic reforms started mid-1991. It has to be done as a complementary part of the ***'de-reservation of industries'***.[41]

(iii) Initially motivated by the need to raise resources for the budgetary allocations.[42]

The approach towards public sector reforms in India has been much more cautious than that of the other developing countries. India did not follow the radical solution to it—under which outright privatisation of commercially viable PSUs is done and of the unviable ones is completely closed.[43] There was an emphasis on increasing functional autonomy of public sector organisations to improve

their efficiency in the 1980s in India as part of the public sector reforms. Once the process of economic reforms started in early 1990s, disinvestment became a part of the public sector reforms. The C. Rangarajan Commission on the Disinvestment of the Public Sector Enterprises (1991) went on to suggest the Government on the issue in a highly commendable and systematic way taking empirical notes from the experiences of disinvestment around the world. The government started the process of disinvestment in 1991 itself. In 1997 the Goverment did set up a Disinvestment Commission to advice upon the various aspects of the disinvestment process. The financial year 1999–2000 saw a serious attempt by the Government to make disinvestment a political process to expedite the process of disinvestment in the country—first a Disinvestment Department and later a full-fledged Ministry of Disinvestment was set up.[44] The new government (UPA) dismantled the Ministry of Disinvestment and today only the Department of Disinvestment is taking care of the matter, working under the Ministry of Finance.

Types of Disinvestment

Since the process of disinvestment was started in India (1991), we see its ***two official types.*** A brief discussion on them is given below:

(i) Token Disinvestment

Disinvestment started in India with a high political caution—in a symbolic way known as the **'*token*' *disinvestment***. The general policy was to sell the shares of the PSUs maximum upto the 49 per cent (i.e. maintaining government ownership of the companies). But in practice, shares were sold to the tune of 5–10 per cent only. This phase of disinvestment though brought some extra funds to the government (which were used to fill up the fiscal deficit considering the proceeds as the 'capital receipts') it could not initiate any new element to the PSUs which could enhance their efficiency. It remained the major criticism of this type of disinvestment, and the experts around the world started suggesting the Government to go for it in the way the ownership could be transferred from the government to the private sector. The other hot issue raised by the experts was related to the question of using the *proceeds* of disinvestment.

(ii) Strategic Disinvestment

In order to make disinvestment a process by which efficiency of the PSUs could be enhanced and the government could de-burden itself of the activities in which the private sector has developed better efficiency (so that the government could concentrate on the areas which have no attraction for the private sector such as the social sector support for the poor masses), the government initiated the process of strategic disinvestment. The Government classifying the PSUs into ***'strategic'*** and ***'non strategic'*** announced in March 1999 that it will generally reduce its stake (share holding) in the ***'non-strategic'*** public sector enterprises (PSEs) to 26 per cent or below if necessary and in the ***'strategic'*** PSEs (i.e. arms and ammunition; atomic energy and related activities; and railways) it will retain its majority holding.[45] There was a major shift in the disinvestment policy from selling small lots of share in the profit-making PSUs (i.e. token disinvestment) to the strategic sale with change in management control both in profit and loss-making enterprises. The essence of the strategic

disinvestment was—

(a) The minimum shares to be divested will be 51 per cent, and

(b) the wholesale sale of shares will be done to a ***'strategic partner'*** having international class experiencfe and expertise in the sector.

This form of disinvestment commenced with the Modern Food Industries Ltd. (MFIL). The second PSUs was the BALCO which invited every kind of criticism from the opposition political parties, the Government of Chattisgarh and experts, alike. The other PSUs were CMC Ltd, HTL, IBPL, VSNL, ITDC (13 hotels), Hotel Corporation of India Ltd. (3 hotels), Paradeep Phosphate Ltd (PPL), HZL, IPCL, MUL and Lagan Jute Manufacturing Company Ltd. (LJMC)—a total number of 13 public sector enterprises, were part of the ***'strategic sale'*** or ***'strategic disinvestment'*** of the PSEs.[46] The new government at the Centre did put this policy of strategic disinvestment on the hold practically and came up with a new policy in place.

Current Disinvestment Policy

The present disinvestment policy[47] was articulated by the UPA-II under its restructured Common Minimum Prgramme (CMP) in 2009 which is based on the ***main ideology*** that:

(a) Citizens have every right to own part of the shares of Public Sector Undertakings

(b) Public Sector Undertakings are the wealth of the Nation and this wealth should rest in the hands of the people, and

(c) While pursuing disinvestment, Government has to retain majority shareholding, i.e. at least 51% and management control of the PSUs.

The ***action plan*** for disinvestment in profit making government companies is:

(i) Already listed profitable PUSs (not meeting mandatory shareholding of 10%) are to be made compliant by 'Offer for Sale' by Government or by the PSUs through issue of fresh shares or a combination of both;

(ii) Unlisted PSUs with no accumulated losses and having earned net profit in three preceding consecutive years are to be listed;

(iii) Follow-on public offers would be considered taking into consideration the needs for capital investment of PSUs, on a case by case basis, and Government could simultaneously or independently offer a portion of its equity shareholding;

(iv) In all cases of disinvestment, the Government would retain at least 51% equity and the management control;

(v) All cases of disinvestment are to be decided on a case by case basis; and

(vi) The Department of Disinvestment is to identify PSUs in consultation with respective administrative Ministries and submit proposal to Government in cases requiring Offer for Sale of Government equity.

Proceeds of Disinvestment: Debate Concerning the Use

In the very next year of disinvestment, there started a debate in the country concerning the suitable use

of the proceeds of disinvestment (i.e. the accruing to the government out of the sale of the shares in the PSUs). The debate has by now evolved to a certain stage coming off basically in three phases:

Phase I: This phase could be considered from 1991–2000 in which whatever money the Governments received out of disinvestment were used for fulfilling the budgetary requirements (better say bridging the gap of fiscal deficit).[48]

Phase II: This phase which has a very short span (2000–03) saw two new developments. *First,* the government started a practice of using the proceeds not only for fulfilling the need of fiscal deficit but used the money for some other good purposes, such as—re-investment in the PSEs, pre-payment of the public debt and social sector. *Second,* by the early 2000–01 a broad concensus emerged on the issue of the proposal by the then Finance Minister.[49] The proposal regarding the use of proceeds of disinvestment was as given below:

Some portions of the disinvestment proceeds should be used

(i) in the divested PSU itself for upgrading purposes
(ii) in the turn-around of the other PSUs
(iii) in the public debt repayment/pre-payment
(iv) in the social infrastructure (education, healthcare, etc.)
(v) in the rehabilitation of the labour-force (of the divested PSUs) and
(vi) in fulfilling the budgetary requirements.

Phase III: The current policy regarding the use of the disinvestment proceeds are as given below:

1. **National Investment Fund:** In January 2005, the GoI decided to constitute a 'National Investment Fund' (NIF)[50] which has the following ***salient features*****:**
   (i) The proceeds from disinvestment of will be channelised into the NIF which is to be maintained outside the Consolidated Fund of India.
   (ii) The corpus of the National Investment Fund will be of a permanent nature.
   (iii) The Fund will be professionally managed, to provide sustainable returns without depleting the corpus, by selected Public Sector Mutual Funds *(they are – UTI Asset Management Company Ltd.; SBI Funds Management Company Pvt. Ltd.; LIC Mutual Fund Asset Management Company Ltd.).*
   (iv) 75% of the annual income of the Fund will be used to finance selected social sector schemes, which promote education, health and employment. The residual 25% of the annual income of the Fund will be used to meet the capital investment requirements of profitable and revivable PSUs that yield adequate returns, in order to enlarge their capital base to finance expansion/diversification.
2. **Using the Proceeds Itself:** In view of the difficult economic situation caused by the global slowdown of 2008-09 and a severe drought that was likely to adversely affect the 11th Plan performance, the GoI, in November 2009, decided to give a *one-time exemption* to utilisation of proceeds from disinvestment for a period of three years from April 2009 to March 2012, i.e. disinvestment proceeds during this period would be available **in full** *(the proceeds itself and not the income accruing from the NIF!)* for meeting the capital expenditure requirements of selected social sector programmes decided by the Planning Commission/Department of

Expenditure. Now as the Country is facing very difficult economic conditions due to continued financial/economic problems in Europe, impacting the economic growth in India, higher subsidy burden relating to petroleum, food and fertilizers, high interest rate impacting the manufacturing sector, affecting excise collection, falling revenue collection, ***the exemption cited above has been extended upto March 2013***[51]**.**

Accordingly, from April 2009, the disinvestment proceeds are being routed through NIF to be used in full for funding capital expenditure under the social sector programmes of the GoI, namely:

(i) Mahatma Gandhi National Rural Employment Guarantee Scheme

(ii) Indira Awas Yojana

(iii) Rajiv Gandhi Gramin Vidyutikaran Yojana

(iv) Jawaharlal Nehru National Urban Renewal Mission

(v) Accelerated Irrigation Benefits Programme

(vi) Accelerated Power Development Reform Programme

INVESTMENT CHALLENGE

As per the recent informations released[52] by the GoI, the concerns and policies regarding the investment scenario in the industrial sector is as given below:

Gross Capital Formation (GCF): Investment and capacity additions are critical for sustained industrial growth- data clearly indicate a moderation in the growth of GCF in industry- the rate of growth of GCF in four broad sectors of industry comprising mining, manufacturing, electricity, and construction averaged 10.9 per cent during **2004-11**, almost the same as the rate of growth of GCF in the economy as a whole. The micro, small, and medium enterprises segment had ***the lowest*** medium-term growth of only 0.8 per cent during this period. The share of GCF in industry as per cent to the overall GCF, after peaking to a level of **54.9** per cent in 2007-8, moderated to **48.3** per cent in 2010-11.

Investment Intentions: While GCF indicates actualisation of investment, investment intentions indicated in the *Industrial Entrepreneur Memorandums* (IEMs) filed are lead indicators of likely investment flow to industry and of entrepreneurs' perception. The investment intentions also provide the sectoral preferences of investors and shifts in these preferences over time. During 2001-10, overall investment indicated in the IEMs filed increased at an average annual rate of 38.7 per cent.

Foreign Direct Investment (FDI): FDI, being a *non-debt capital flow*, is a leading source of external financing, especially for the developing economies. It not only brings in capital and technical know-how but also increases the competitiveness of the economy. Overall it supplements domestic investment, much required for sustaining the high growth rate of the country. Since 2000, significant changes have been made in the FDI policy regime by the government to ensure that India becomes an increasingly attractive and investor-friendly destination.

The current phase of FDI policy is characterised by ***three broad entry options*** for foreign direct investors –

(i) in few sectors, FDI is not permitted (negative list);

(ii) in another small category of sectors, foreign investment is permitted only till a specified level of foreign equity participation; and

(iii) the third category, comprising all the other sectors, is where foreign investment up to 100 per cent of equity participation is allowed. The third category has two subsets:

(a) one consisting of sectors where automatic approval is granted for FDI (often foreign equity participation less than 100 per cent) and

(b) the other consisting of sectors where prior approval from the Foreign Investment Approval Board (FIAB) is required.

Cumulative amount of FDI inflows from April 2000 to December 2011 stood at US$ 240.06 billion, out of which FDI *equity inflows* amounted to US$ 157.97 billion. FDI inflows declined globally in 2009 and 2010. While India was able to largely insulate itself from the decline in global inflows in 2009-10, FDI flows moderated in 2010-11.

Services (financial and non-financial), telecom, construction, drugs & pharmaceuticals, Metallurgical Industries and power were the sectors that attracted maximum (around 84 per cent) FDI during 2011-12. Cabinet cleared 100% FDI in Single Brand retail and 51% FDI in Multi Brand Retail. The decision regarding Multi Brand Retail is suspended till the consensus is developed through consultation among various stakeholders.

NEW STEPS TO BOOST MANUFACTURING

The GoI has taken several specific initiatives have to strengthen industry, particularly the manufacturing sector. The 12th Plan document lays down broad strategies for spurring industrial growth and recommends sector specific measures covering micro, small, medium and large industries in the formal as well as informal sector. Some of the major initiatives that can change the manufacturing landscape of India are as follows[53]–

National Manufacturing Policy (NMP)

It was approved by the government in October, 2011. The major objectives of the policy are:

- Enhancing the share of manufacturing in gross domestic product (GDP) to 25 per cent and creating an additional 100 million additional jobs over a decade or so.
- providing special focus to industries that are employment intensive, those producing capital goods, those having strategic significance, small and medium enterprises, and public sector enterprises besides industries where India enjoys a competitive advantage.
- Promotion of clusters and aggregation, especially through the creation of National Investment and Manufacturing Zones (NIMZs).
- Out of twelve NIMZs so far announced, eight are along the DMIC. Besides, four other NIMZs have been given in-principle approval –

  (i). Nagpur in Maharashtra,

(ii). Tumkur in Karnataka,
(iii). Chittoor district in Andhra Pradesh, and
(iv). Medak district in Andhra Pradesh.

DMIC Project

The industrial development initiatives under DMIC (Delhi-Mumbai Industrial Corridor) [54] project presently cover *eight* industrial cities that are proposed to be developed along the railway corridor. The Master Planning for the investment regions and industrial areas taken up initially to be developed as *new cities* in Gujarat, Madhya Pradesh, Haryana, Rajasthan and Maharashtra have been completed and master planning in Uttar Pradesh has started. The State governments have initiated the process of obtaining land for the new industrial regions/areas as well as for the Early Bird Projects. For five industrial cities EIA (Environmental Impact Assessment) studies have been initiated.

FDI Policy

Following the policy reform process, the FDI policy is being progressively liberalized on an ongoing basis in order to allow FDI in more industries under the automatic route. Some recent changes in FDI policy, besides consolidation of the policy into a single document include FDI in multi-brand retail trading up to 51 per cent subject to specified conditions; increasing FDI limit to 100 per cent in single-brand retail trading; FDI up to 49 percent in civil aviation and power exchanges; FDI up to 49 percent in broadcasting sector under the automatic route and FDI above 49 percent and up to 74 percent under the Government route both for teleports and mobile TV.

The e-Biz Project

The government has announced the setting up of – ***Invest India*** – a joint-venture company between the Department of Industrial Policy and Promotion and FICCI, as a *not-for-profit*, single window facilitator, for prospective overseas investors and to act as a structured mechanism to attract investment. In addition, the Government has initiated implementation of the e-Biz Project, a mission mode project under the NeGP (National e-Governance Plan) for promoting an *online single window* at the national level for business users. The objectives of setting up of the **e-Biz** portal are to provide a number of services to business users, covering the entire life cycle of their operation. The project aims at enhancing India's business competitiveness through a service oriented, event-driven **G2B** (Government to Business) interaction.

New IIP

The Ministry of Statistics & Programme Implementation recently (May 2011) released[55] the ***new series*** of *Index of Industrial Production (IIP)* with 2004-05 as its base which was released on 10th June, 2011. The old series of IIP (Base: 1993-94=100) was discontinued from the month of September, 2011.

Sl. No.	*Sector*	*Items*	*Items Groups*	*Weight*

		1993-94	2004-05	1993-94	2004-05	1993-94	2004-05
1.	Mining	64	61	1	1	104.73	141.57
2.	Manufacturing	473	620	281	397	793.58	753.27
3.	Electricity	1	1	1	1	101.69	103.16
4.	Total	538	682	283	399	1000.00	1000.00

The revision of base year of IIP was undertaken based on the recommendations of the *Standing Committee on Industrial Statistics (SCIS),* constituted by the Ministry of Statistics & Programme Implementation. The SCIS includes members from concerned Ministries, and it is presently chaired by Dr. Biswanath Goldar, Professor, *Institute of Economic Growth.* The National Statistical Commission (NSC) also recommended revision of base year of IIP to 2004-05.

The **salient features** of new series of IIP are as follows:

(a) A representative item basket comprising 682 individual items has been selected for the new series of IIP. Further, and a new weighting diagram which better reflects the present structure and composition of the industry due to changes in the technology, economic reforms and production behaviour over time, is derived for the new series.

(b) The new series of IIP covers the sectors of mining, manufacturing and electricity in its scope as in the current series. For the compilation of sectoral weights for these three main sectors, GDP at factor cost available from the National Accounts Statistics (2010) is used.

(c) The result of the Annual Survey of Industries (ASI): 2004-05 is used as the basic frame for the selection of products for the manufacturing sector. However, for deciding the industry level (NIC 2 digit) weights of the manufacturing sector, the estimates of Gross Value Added (GVA) as per ASI: 2004-05 for the organised manufacturing sector and as per the 62nd round of the National Sample Survey for the unorganised manufacturing sector are used.

(d) Sector-wise comparative statements of *weights, number of items* and *item groups* between the old series and new series are as given below:

(e) The monthly production data for the compilation of new series of IIP are being made available to the CSO by sixteen (16) source agencies which includes the Indian Bureau of Mines (IBM), Directorate of Sugar, Office of the Salt Commissioner, etc. among others. Out of these, the Indian Bureau of Mines compiles the monthly indices for the mining sector and supplies the same to the CSO, which is suitably dovetailed with the indices for manufacturing and electricity sectors to arrive at the general index.

(f) Some of the important ***items newly included*** in the series basket are ‘Milk, skimmed, pasteurised’, ‘Rice’, ‘Cattle and poultry feed’, ‘Woollen carpets’, ‘Apparels’, ‘Writing & printing paper’, ‘Newspapers’, ‘Propylene’, ‘Complex grade fertilisers’, ‘Antibiotics & it’s preparations’, ‘Polythene bags, ‘Glass sheet’, ‘Marble tiles/slabs’, ‘Aluminium’, ‘Steel structures’, ‘Colour TV sets’, ‘Lens of all kinds’, ‘Wood furniture’, ‘Coir mats & matting’, ‘Gems and jewellery’, ‘Copper and copper products’ and ‘Molasses’.

Major changes due to base revision

(i) The base year of IIP for the new series is 2004-05, as against 1993-94 for the old series.

(ii) The weighting diagram has undergone change due to base revision.

(iii) The total coverage of products has increased at the overall level.

(iv) National Industrial Classification (NIC)-1987 was used in the old series whereas for the new series, ***NIC-2004*** has been used.

(v) As such, at industry level, monthly index and their growth is being published for 22 industry groups for the new series, whereas for the old series, the monthly index and growth was released for 17 industry groups.

(vi) 14 out of 15 source agencies are retained in new series. Department of Chemicals & Petrochemicals and Department of Fertilizers are included in the new series as independent source agencies because of growing importance of their respective industries.

(vii) Ministry of Micro, Small & Medium Enterprises (MSME) is presently ***excluded*** as a source agency for new series of IIP, though bigger units of MSME sector, which are part of the coverage of Annual Survey of Industries (ASI) are already included in the item basket. CSO held dialogues with the representatives from Office of the Development Commissioner (DC), MSME for identifying products and units from the recently completed *4th all India Census-cum-Survey of MSME Sector* and accordingly putting in place a new system of regular monthly collection of data. After the system of data collection is in place, DC (MSME) may develop the ***index for the MSME sector separately.*** This monthly index will be finally dovetailed with the General Index of All-India IIP by assigning a proper weight through suitable methodological framework. This view was also endorsed by the CSO.

INDUSTRY & ENVIRONMENT

The development of a diversified industrial structure in India, based on a combination of large and small-scale industries, and growing urban and rural population have produced pressures on the environment as reflected in the growing incidence of air, water, and land degradation. Industrial pollution is *concentrated* in industries like petroleum refineries, textiles, pulp and paper, industrial chemicals, iron and steel, and non-metallic mineral products. *Small scale industries,* especially foundries, chemical manufacturing, and brick making, are also significant polluters. In the *power sector,* thermal power, which constitutes the bulk of installed capacity for electricity generation, is an important source of air pollution. Current situation[56] of industrial pollution is as given below:

- Analysis of long-term trends (1995-2009) of **air pollutants** shows that while SO_2 has been under control, NO_2 has exceeded permissible levels in 11-23 per cent cities during last the 15 years.
- Discharge of untreated or partially treated industrial **emissions** and effluents is the main cause of industrial pollution. Industrial effluents comprising organic pollutants, chemicals, and heavy metals and run-off from landbased activities such as mining are a major source of water pollution. The *major water-polluting industries* include fertilisers, refineries, pulp and paper, leather, metal plating, and other chemical industries.[57]
- Continued monitoring of water quality of aquatic resources has revealed that organic pollution

continues to be the predominant pollutant of aquatic resources. It has also been estimated that 75 per cent of the water pollution is on account of disposal of untreated/partially treated *sewage* by local bodies.

- The problem of water quality has further been aggravated because of *diminishing water flow in rivers*. The Central Pollution Control Board (CPCB) is monitoring water quality of rivers at 980 locations covering 353 rivers in terms of Dissolved Oxygen (DO), Bio-chemical Oxygen Demand (BoD), and fecal coliforms. One hundred and fifty stretches on 105 rivers have been identified as polluted.
- It is estimated that around 57 million tonnes per annum of municipal solid waste (MSW) is presently generated in the country. Based on its physico-chemical characteristics, the MSW generated in Indian cities is suitable for composting. However, presently the country has a rated capacity of processing around 6,000 tonnes per day of mixed waste into compost. Lack of proper enforcement for disposal of hazardous waste results in abandoned hazardous waste dumps, some of which bioaccumulate through the *food chain,* thereby posing long-term health risks.
- Approximately 15,722 tonnes of plastic waste is generated in the country per day, only *60 per cent of which is recycled* due to low collection efficiency. Fly ash, phospogypsum, and iron and steel slags are the major forms of industrial solid wastes- around 160 million tonnes per annum of fly ash is generated, of which only 91.2 million tonnes per annum is utilized by cement plants, road embankments, fly ash bricks, and back filling of mines, etc.

ECONOMIC SURVEY 2012-13 ON INDUSTRY

The inputs and advice of the government document on industry may be summarised as has been given below –

- After recovering to a growth of 9.2 per cent in 2009-10 and 2010-11, growth of value added in industrial sector, comprising manufacturing, mining, electricity and construction sectors, slowed to 3.5 per cent in 2011-12 and to ***3.1 percent in 2012-13***.
- Industrial growth still remains vulnerable to several domestic factors and external shocks – Infrastructure and energy constraints, decline in demand for India's exports, and fragile recovery in investment are the risk factors. The latest lead indicators suggest mixed signals about whether a growth upturn is underway. The policy initiatives taken by the government in the recent months made the business sentiment buoyant and have generated some optimism.
- Revival of investment in industry and key infrastructure sectors is the key challenge. Industrial sector has been hit hard by the deceleration in investment for the *second successive year*. As per the latest first revised estimates of GDP, gross capital formation in the manufacturing sector in 2011-12 (at 2004-05 prices) had declined by 18.8 per cent as compared to 2010-11.
- Lower foreign direct investment inflows in key industry and infrastructure sectors during April-October 2012 at $ 6.19 billion as against the inflow of $18.66 billion during the same period of the previous year. Investment intentions indicated in the industrial entrepreneur

memorandum (IEMs) filed, which are lead indicators of likely investment flows to industry, also declined in 2011 and 2012.

- A marginal pickup in the gross bank credit deployment into industrial sector in recent months, year on year increase in gross bank credit deployment as on end December 2012 has been 13.8 per cent as compared to 19.8 per cent a year ago.
- Besides weak investment climate, industrial sector performance remained subdued due to *infrastructure bottlenecks*. Industrial growth rate moderated due to sharp decline in output of natural gas; subdued performance of the coal sector and its resultant impact on thermal power generation; and slow pace of project implementation in rail, road, and ports sectors. In the medium term, it is therefore crucial to accelerate the output of core sectors and speed up implementation of crucial big ticket projects.
- The key underpinning cause of the recent industrial slowdown has been the manufacturing sector. India's manufacturing value-added (MVA) as share of GDP, has remained sticky at around 15 per cent. As per the *latest* competitive industrial performance index (CIP) compiled by *UNIDO* for the year 2009, India was placed 42nd out of the 118 countries. India's low CIP ranking hints at the *underlying weaknesses* and *vulnerabilities* despite being one of the top ten manufacturing nations. India's manufacturing sector, therefore, needs to acquire dynamism and technological sophistication to become one of the leading manufacturers. From the long term point of view, low level of R&D and inadequate availability of skilled manpower would adversely affect India's competitiveness and the manufacturing growth.
- India has not improved significantly in terms of the ease of doing business and ranks very low in comparison to other industrial peers. The MSME sector in particular faces multiple approval and operational restrictions. The process of setting up and exiting business is time consuming and complicated requiring expensive third party assistance. Since states have the major role in administering MSME sector, the prevailing ecosystem therefore varies from state to state. Exit rules as per the Companies Act, 1956 are complex and costly and do not permit reaping the benefits from reallocation of resources.
- *Finance* at competitive cost is another major constraint for both the organized and the unorganized MSME enterprises. Financing other than internal accruals is costly and prohibitive. The Prime Minister's Task Force on MSMEs had recom ended a 20 per cent year-on-year growth in credit to micro and small enterprises to ensure enhanced credit flow. It had also recomended allocation of 60 per cent of the micro and small enterprises advances to the micro enterprises to be achieved in a phased manner. The resource flow, however, needs to improve.
- Research and technology upgradation activities also need to be scaled up. Presently only a small number of incubators operates in the country which is very low relative to other countries. New incubators will need to be set up on a Public-Private Partnership basis. To attract more investment and talent, incubators need to be allowed to distribute profits back to investors. With some of these changes indutrial growth could become steadier.

An Introduction

Infrastructure is the 'lifeline' of an economy as protein is the lifeline for the human body. Whichever sector be the prime moving force of an economy i.e. primary, secondary or tertiary, suitable level of infrastructure presence is a pre-requisite of growth and development. This is why the government in India has always given priority to the developmental aspects of the sector. But the level of preparedness and performance had been always less than required by the economy. Which sector are called the infrastructure? ***Basically, the goods and services usually requiring higher investment, considered essential for the proper functioning for an economy is called the infrastructure of an economy*** (**definition**)[58]. Such sector might be as many as required by a particular economy such as power, transportation, communication, water supply, sewerage, housing, urban amenities, etc.

There are three sectors which are considered as the infrastructure universally around the world namely power, transportation and communication. Since, the infrastructure benefits the whole economy, it has been often argued by the economists that the sector should be funded by the government by means of taxation, partly in not wholly.

Indian infrastructure sector is clearly overstrained and has suffered from underinvestment in the post-reforms period[59]. Infrastructure bottlenecks are always constraint in achieving a higher growth for the economy. India needs massive investment both from the public and private sectors to overcome here infrastructure bottlenecks. Investments by the public and private sectors are not alternatives but complimentary to each other as the required investment is very high. Public investment in the sector depends upon the ability to raise resources (capital) in the public sector and this in turn depends upon the ability to collect the user charges from the consumers. To make this happen following ***three*** factors are extremely important:

(i) Reform of the power sector,

(ii) Introduction of road user charges (either directly via tolls or indirectly via a cess on petrol diesel), and

(iii) Rationalisation of railway fares.

The experts[60] have suggested for expanding public investment in the sector supplemented duly by a vigorous effort of attracting private investment (domestic as well as foreign). Creating the conducive environment to attract private investment in the infrastructure should include:

(i) Simplification and transparency in the clearance procedures;

(ii) Unbundling an infrastructure project so that the private sector may go for only those unbundled segment of the project whose they are able to bear; and

(iii) Providing credible and independent regulatory framework so that the private players get fair treatment.

Official Ideology

Putting in place the quality and efficient infrastructure services is essential to realise the full potential

of the growth impulses surging through the Indian economy. There is now a widespread consensus[61] (now clearly accepted by the Planning Commission) that exclusive dependence on government for the provision of all infrastructure services introduces difficulties concerning adequate scale of investment, technical efficiency, proper enforcement of user charges, and competitive market structure. At the same time, complete reliance on private production, particularly without appropriate regulation, is also not likely to produce optimal outcomes[62]. India, while stepping up public investment in infrastructure, has been actively engaged in finding the appropriate policy framework, which gives the private sector adequate confidence and incentives to invest on a massive scale, but simultaneously preserves adequate checks and balances through transparency, competition and regulation.

The 11th Plan[63] emphasised the need for removing infrastructure bottlenecks for sustained growth – proposed an investment of US $500 billion in infrastructure sectors through a mix of public and private sectors to reduce deficits in identified infrastructure sectors. As a percentage of the gross domestic product (GDP), investment in infrastructure was expected to increase to around 9 per cent. For the first time the contribution of the private sector in total investment in infrastructure was targeted to exceed 30 per cent. Total investment in infrastructure during the Eleventh Plan is estimated to increase to more than 8 per cent of GDP in the terminal year of the Plan, which was higher by 2.47 percentage points as compared to the Tenth Plan. The private sector is expected to be contributing nearly 36 per cent of this investment.

An analysis[64] of the creation of infrastructure in physical terms indicates that while the achievements in some sectors have been remarkable during the Eleventh Plan as compared to the previous FiveYear Plans, there have been slippages in some sectors. The success in garnering private-sector investment in infrastructure through the public-private partnership (PPP) route during the Plan has ***laid solid foundation*** for a substantial step up in private-sector funding in coming years. PPPs are expected to augment resource availability as well as improve the efficiency of infrastructure service delivery.

The Planning Commission[65], in its aproach paper has projected an investment of over Rs. 45 lakh crore (for about US $1 trilion) during the **Twelfth Plan (2012-17).** It is projected that at least 50 per cent of this investment will come from the private sector as against the 36 per cent anticipated in the Eleventh Plan and public sector investment will need to increase to over Rs. 22.5 lakh crore as against an expenditure of Rs. 13.1 lakh crore during the Eleventh Plan. Financing infrastructure will, therefore, be a big challenge in the coming years and will equire some innovative ideas and new models of financing.

Sectoral Situation & Initiatives[66]

Power deficit: The deficit in power supply in terms of peak availability and total energy availability declined during the Eleventh Five Year Plan. While the energy deficit decreased from 9.6 per cent in the terminal year of the Tenth Plan (2006-7) to 7.9 per cent during April-December 2011, peak deficit declined from 13.8 per cent in 2006-7 to 10.6 per cent during the current financial year (up to December 2011). *Capacity addition* during the Eleventh Plan is, therefore, expected to be about 50,000 to 52,000 MW.

Ultra Mega Power Projects (UMPPs) Initiative for development of coal-based super critical UMPPs, each of about 4000 MW capacity, under Case II bidding route. *National Grid* helps to even out supply-demand mismatches. The existing inter-regional transmission capacity of 23,800 MW connects the northern, western, eastern, and north-eastern regions in a synchronous mode operating at the same frequency and the southern region asynchronously operating in the same mode. This has enabled inter-regional energy exchanges of about 39,275 million units (MUs) during April-November 2011, thus contributing to better utilisation of generation capacity and an improved power supply position. Proposals are under way for synchronous integration of the southern region with other regions.

Competition in the electricity sector has been augmented by having an ***open access*** system allowing a buyer to choose his supplier and a seller to choose his buyer. Open access at inter-state transmission level is now fully functional. The facilitative framework created by the Central Electricity Regulatory Commission (CERC) in this regard has provided the desired regulatory certainty for developers in terms of market access, and also payment security against default.*Central Transmission Utility (CTU)* which is responsible for granting connectivity, medium-term open access, and long-term access, has received 141 applications for connectivity involving generation capacity of 1,52,850 MW.

Trading of Electricity is enabled through electricity traders and power exchanges. Power trading helps generation resource optimisation by facilitating trade and flow of power across the country with varied geography, climatic conditions, and natural resource endowments. It has helped in sale of surplus power available with distributing utilities and captive power plants on one hand and purchase of power by deficit utilities to meet sudden surges in demand. Short-term markets also provide generators with an alternative to sell power other than through long-term power purchase agreements (PPAs). The CERC grants inter-state trading licences.

National Electricity Fund (Interest Subsidy Scheme) has been approved by to provide interest subsidy (Rs. 8,466 crore) on loan to the state power utilities, both in the public and private sectors, to improve the **distribution network**. The preconditions for eligibility to avail of interest subsidy are linked to the reforms in the power sector and the amount of interest subsidy is linked to the progress achieved in reforms.

AT&C Losses: Due to lack of adequate investment on 'transmission and distribution' (T&D) works, the T&D losses have been consistently on higher side, and reached to the level of 32.86% in the year 2000-01.The reduction of these losses was essential to bring economic viability to the State Utilities (the SEBs). As the T&D loss was not able to capture all the losses in the net work, concept of *Aggregate Technical and Commercial (AT&C)* loss was introduced. AT&C loss captures technical as well as commercial losses in the network and is a true indicator of total losses in the system.

High technical losses in the system are primarily ***due to*** inadequate investments over the years for system improvement works, which has resulted in unplanned extensions of the distribution lines, overloading of the system elements like transformers and conductors, and lack of adequate reactive power support.

The commercial losses are mainly due to:

(i) low metering efficiency

(ii) theft, and

(iii) pilferages

This may be eliminated by improving metering efficiency, proper energy accounting & auditing and improved billing & collection efficiency. Fixing of accountability of the personnel/feeder managers may help considerably in reduction of AT&C loss.

With the initiative of the Government of India and of the States, the ***Accelerated Power Development & Reform Programme*** (APDRP) was launched in 2001, for the strengthening of Sub Transmission and Distribution network and reduction in AT&C losses. The main objective of the programme was to bring Aggregate Technical & Commercial (AT&C) losses below 15% in five years in urban and in high-density areas – the loss as percentage of turnover was reduced from 33% in 2000-01 to 16.60% in 2005-06.

The APDRP programme has been *restructured*. The Restructured APDRP (R-APDRP) was launched in July 2008 as a central sector scheme for the 11th Plan (in order that reliable and verifiable baseline data of revenue and enegry in APDRP Project areas is attained over an IT plateform and that AT& C loss reduction is achieved on a sustained basis).

Development of Multifunctional Complex (MFC): A new concept of development of MFCs with *budget hotels* was introduced in the *Rail Budget 2009-10,* so that important facilities may be available to rail users in a separate complex in the vicinity of the circulating area on station- a total of 198 stations have been identified by now.

In a major move to give further impetus to ***railways' modernization*** plans, an Expert Group has been constituted under the Chairmanship of Shri Sam Pitroda to recommend ways and means of meeting the challenges of economic growth, the aspirations of the common man, the needs of changing technology, and the expanding market, while at the same time ensuring adequate focus on addressing the social and strategic requirements of the country consistent with Indian Railways' national aspirations. The terms of reference of the Group involve outlining strategies for modernisation of Railways with focus on track, signalling, rolling stock, stations and terminals upgradation; using ICT for improving efficiency and safety; augmenting existing capacities of Railways through indigenous development; reviewing projects; and addressing PPP issues. The Expert Group is expected to submit its report by March 2012.

In order ***to attract private capital*** for accelerated construction of fixed rail infrastructure, GoI has formulated PPP investment models. A comprehensive draft policy is under the consideration which would replace the existing Railways Infrastructure for Industry Initiative (**R3i**) and Railways Policy for Connectivity to Coal and Iron Ore Mines (**R2CI**) policies for private investments in rail connectivity projects.

National Highways Development Project (NHDP): About 22 per cent of the total length of National Highways (NHs) is single lane/ intermediate lane, about 53 per cent is two lane standard, and the balance 25 per cent is four lane standard or more.

Financing of the NHDP: A part of the **fuel cess** imposed on petrol and diesel is allocated to the NHAI for funding the implementation of the NHDP. The NHAI leverages the cess flow to borrow additional funds from the debt market. Till date, such borrowings have been limited to funds raised through 54 EC (capital gains tax exemption) bonds and the short-term overdraft facility. Government has also taken loans for financing projects under the NHDP from the World bank (US$ 1,965 million), Asian Development Bank (US$ 1,605 million) and Japan Bank for International Cooperation

(32,060 million yen) which are passed on to the NHAI partly in the form of grants and partly as loan. The NHAI has also availed a direct loan of US$ 149.78 million from the ADB for the Manor Expressway Project.

Special Accelerated Road Development Programme for North-East region (SARDP-NE) aims at improving road connectivity to state capitals, district headquarters, and remote places of the north-east region. Development of roads in Left Wing Extremism *(LWE)*-affected areas in the states of Andhra Pradesh, Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Maharashtra, Odisha, and Uttar Pradesh is continuing; Prime Minister's Reconstruction Plan *(PMRP)* for Jammu and Kashmir, launched in November 2004.

Pradhan Mantri Gram Sadak Yojna (PMGSY): Launched to provide single all-weather road connectivity to eligible unconnected habitations having population of 500 persons and above in plain areas and 250 persons and above in hill states, tribal (Schedule V) areas, desert (as identified in the Desert Development Programme) areas, and LWE-affected districts as identified by the Ministry of Home Affairs. Rural roads has also been identified as one of the ***six components*** of Bharat Nirman which has the goal of providing all-weather road connectivity to all villages with a population of 1,000 (500 in the case of hilly or tribal areas).

The Eleventh Plan had envisaged accelerated efforts to bring the NH network up to a ***minimum two-lane*** standard by the end of the **Twelfth Plan** and for removing existing deficiencies. In order to make a visible impact, the work would be taken up for upgradation on a corridor concept. These corridors would include strengthening (in adjoining reaches) in addition to widening to two-lane/two-lane with paved shoulder standards in order to have better facility over long continuous stretches.

Civil Aviation: Airport infrastructure development continues to be a matter of concern. Upgradation of many airports, including construction of new terminals, upgradation in 18 non-metro airports, for improving air navigation services the Airport Authority of India (AAI) installing the new ATS automation system. In order to address issues concerning viability of the civil aviation sector, particularly the airline industry, a Working Group was constituted on 12 December 2011 under the chairmanship of the Secretary civil aviation. Their major recommendations were:

(a) state governments should rationalise the value added tax (VAT) on aviation turbine fuel (ATF),
(b) foreign airlines be permitted to invest in domestic airlines undertakings,
(c) direct import of ATF by airlines for their own consumption be allowed,
(d) airlines should be asked to prepare their turnaround plans,
(e) fare structure should be reviewed by airlines to cover the cost of their operations.
(f) an economic regulatory framework suggested with regard to excessive/predatory pricing by 31 May 2012.

Maritime Agenda 2010-2020: The **objective** of the Maritime Agenda 2010-2020 is not only creating more capacity but setting up ports on a par with the best international ports in terms of performance:

(i) A target of 3,130 MT port capacity has been set for the year 2020. More than 50 per cent of this capacity is to be created in the non-major ports as the traffic handled by these ports is expected to increase to 1,280 MT.
(ii) This enlarged scale of operation is expected to reduce transaction costs considerably and

make Indian ports *globally competitive.*

(iii) Proposed investment in major and non-major ports by 2020 is expected to be around Rs. 2,96,000 crore.

(iv) Most of the investment to come from the private sector including foreign direct investment FDI (up to 100 per cent under the automatic route is permitted for construction and maintenance of ports), around 96 per cent, private sector to fund most of the projects through PPP or on 'build operate transfer' (BOT) or 'build operate own transfer' (BOOT) basis.

(v) Private-sector participation will not only increase investment in the ports infrastructure, it is expected to improve operations of the ports through the induction of the latest technology and better management practices.

(vi) Public funds will be mainly deployed for common use infrastructure facilities like deepening of port channels, rail and road connectivity from ports to hinterland, etc.

Urban Infrastructure: Jawaharlal Nehru National Urban Renewal Mission (JNNURM) has been launched by the Ministry of Urban Development for a seven-year period (i.e. up to March 2012) to encourage cities to initiate steps to bring about improvements in a phased manner in existing civic service levels. The components under the sub-mission Urban Infrastructure and Governance (UIG) include urban renewal, water supply (including desalination plants), sanitation, sewerage and solid waste management, urban transport, development of heritage areas, and preservation of water bodies.

The UIDSSMT *(Urban Infrastructure Development Scheme for Small and Medium Towns)* is a ***sub-component*** of the JNNURM for development of infrastructure facilities in all towns and cities other than the 65 Mission cities covered under UIG (Urban Infrastructure and Governance) Sub-mission of the JNNURM. For obtaining assistance under the UIDSSMT, states and urban local bodies (ULBs) need to sign MoAs committing to implementation of the reforms.

Under the pilot scheme, *Urban Infrastructure Development in Satellite Towns around Seven Mega-Cities,* launched in 2011-12 to contribute towards amelioration of basic services in these towns. For the north-eastern region, the *North Eastern Region Urban Development Program* was launched in November, 2009 with Asian Development Bank (ADB) assistance. The project aims to assist the states of Tripura, Mizoram, Sikkim, Meghalaya, and Nagaland to address challenges of urban development in their capital cities.

Urban Transport is one of the key elements of urban infrastructure. As compared to private modes of transport, public transport is energy efficient and less polluting. The public transport system helps improve urban-rural linkages and access of rural/semi-urban population in the periphery to city centres for the purposes of work without proliferation of slums within and around cities. National Urban Transport Policy (NUTP), 2006 **aims** to ensure accessible, safe, affordable, quick, comfortable, reliable, and sustainable mobility for all – under which several projects of 'bus rapid transit system' (BRTSs) and 'Metro Rail Projects' have been sanctioned by may 2012.

Financing Infrastructure: Net bank credit to infrastructure had a healthy growth of 48.4 per cent per annum during 2006- 11 but it turned negative 2011-12 and was around 61 per cent of 2010-11 – power and telecom sectors saw significant reduction. FDI inflows registered 23.6 per cent growth in 2011-12 with power (43.6 per cent), non-conventional energy (338 per cent) and telecommunications (499 per cent) the preferred sectors for foreign investors- ther sectors, however, failed to share the buoyancy in FDI inflows.

ENERGY PRICING

The economic role of rational energy pricing can hardly be under-estimated. Rational energy prices provide the right signals to both the producers and consumers and lead to a demand-supply match, providing incentives for reducing consumption on the one hand and stimulating production on the other. Aligning domestic energy prices with the global prices, especially when large imports are involved, may be ideal option as misalignment could pose both micro- and macroeconomic problems.

At microeconomic level, underpricing of energy to the consumer not only reduces the incentive for being energyefficient, it also creates fiscal imbalances. Leakages and inappropriate use may be the other implications. Underpricing to the producer reduces both his incentive and ability to invest in the sector and increases reliance on imports. Over the years, India's energy prices have become misaligned and are now much lower than global prices for many products. The extent of misalignment is substantial, leading to *large untargeted subsidies*. Several initiatives have been taken by the GoI for rationalizing the energy prices in different sectors –

- The Integrated Energy Policy has outlined the broad contours of the pricing system for coal. The *pricing of coal* is done now on gross calorific value (GCV) basis with effect from 31 January 2012, replacing the earlier system of pricing on the basis of useful heat value (UHV) which takes into account the heat trapped in ash content also, besides the heat value of carbon content. The revision in the GCV is likely to increase the prices of domestic coal to some extent, but this is a desirable adjustment because domestic thermal coal, adjusted for quality differences, continues to be underpriced.
- In case of petroleum products pricing, the government dismantled the Administered Pricing Mechanism in 2002. This decision, however, was not fully implemented and domestic pass through of global price increases remained low for petrol, diesel, kerosene, and LPG – in June 2010, the government announced that the *price of petrol was fully deregulated* and the oil companies were free to fix it periodically.
- In *January 2013*, the government announced the new roadmap providing for a gradual price increase for reducing *diesel under-recoveries*.
- Admissibility of subsidized number of liquefied petroleum gas (LPG) cylinders and prices of LPG have also recently been revised. Pricing of gas is presently done under the New Exploration Licensing Policy (NELP). The government provides the operator freedom to sell the gas produced from the NELP blocks at a market-determined price, subject to the approval of pricing formula. The government is reviewing pricing under the PSC (price sharing contract) to clarify the extent to which producers will have the freedom to market the gas.

DEDICATED FREIGHT CORRIDOR

The Eastern and Western Dedicated Freight Corridors (DFC) are a mega rail transport project being undertaken to increase transportation capacity, reduce unit costs of transportation, and improve

service quality –

- The Eastern DFC (1839 route kilometres [RKM]) extends from Dankuni near Kolkata to Ludhiana in Punjab, while the Western DFC (1499 RKM) extends from the Jawahar Lal Nehru Port (JNPT) in Mumbai to Dadri /Rewari near Delhi.
- A special purpose vehicle, the *Dedicated Freight Corridor Corporation of India Limited* has been set up to implement the project. Out of 10,703 ha of land to be acquired for the project, 7,768 ha (73 per cent) has already been awarded under the Railway Amendment Act (RAA) 2008.
- The Eastern and Western DFC projects are being *funded* through a mix of bilateral/multilateral loans, gross budgetary support (GBS), and PPP. The Western DFC is being funded by the Japan International Cooperation Agency (JICA) up to 77 per cent of the total cost.
- The Ludhiana to Mughalsarai section (1183 km) of the Eastern DFC is being funded by the World Bank up to 66 per cent of the project cost.
- The Mughalsarai-Sonnagar sector (122 km) will be funded by Indian Railways' own resources.Civil construction work of this sector is in progress.
- The Dankuni-Sonnagar section (534 km) of the Eastern DFC to be funded through PPP mode.
- After commissioning of the Eastern and Western DFCs, it is planned to upgrade the speed of passenger trains to 160-200 kmph on the existing routes. A feasibility study for upgradation of speed of passenger trains to 160-200 kmph on the existing Delhi-Mumbai route has been undertaken with co-operation from the Government of Japan in 2012-13.

Apart from the Eastern and Western DFCs, a feasibility study has also been undertaken on four ***future*** freight corridors, viz. East-West Corridor (Kolkata-Mumbai), North-South Corridor (Delhi-Chennai), East Coast Corridor (Kharagpur-Vijayawada) and Southern Corridor (Goa-Chennai). A pre-feasibility study of the Chennai-Bangalore Freight Corridor is also being proposed.

PPP: NEW STEPS

The GOI is promoting PPPs as 'an effective tool for bringing private-sector efficiencies in creation of economic and social infrastructure assets' and for 'delivery of quality public services'. India in recent years has emerged as one of the *leading PPP markets in the world*, because of several policy and institutional initiatives. By end ***December 2012*** there were over 900 PPP projects in the infrastructure sector with total project cost (TPC) of Rs. 5,43,045 crore as compared to over 600 projects with TPC of Rs. 333,083 crore on 31 March 2010. These projects are at different stages of implementation, i.e. bidding, construction, and operational.

Approval of Central-sector PPP Projects: Since its constitution in January 2006, the Public Private Partnership Appraisal Committee (PPPAC) has approved 307 central project proposals with TPC of Rs. 2,97,856.58 crore. These include NHs (242 proposals), ports (29 proposals), airports (2 proposals), tourism infrastructure (1proposal), railways (1 proposal), housing (27 proposals), and sports stadia (5 proposals).

VGF for PPP Projects: Under the Scheme for Financial Support to PPPs in Infrastructure (Viability Gap Funding Scheme), 145 projects have been granted approval. Thirteen new sub-sectors have been included in the list of sectors eligible for VGF support under the Scheme which are –

i. Capital investment in the creation of modern storage capacity including cold chains and post-harvest storage.

ii. Education, health, and skill development.

iii. Internal infrastructure in National Investment and Manufacturing Zones.

iv. Oil/gas/liquefied natural gas (LNG) storage facility [includes City Gas distribution (CGD) network]; oil and gas pipelines (includes CGD network); irrigation (dams, channels, embankments, etc); telecommunication (fixed network) (includes optic fibre/ wire/cable networks which provide broadband /internet); telecommunication towers; terminal markets; common infrastructure in agriculture markets; and soil-testing laboratories.

Support for Project Development of PPP Projects: The India Infrastructure Project Development Fund (IIPDF) was launched in December 2007 to facilitate quality project development for PPP projects and ensure transparency in procurement consultants and projects. So far, 51 projects have been approved.

Capacity Building and Strengthening of State and Central Institutions: The National PPP Capacity Building Programme was launched in December 2010, and was rolled out last year in 15 States and two central training institutes, viz. the Indian Maritime University and Lal Bahadur Shastri National Academy of Administration. A comprehensive curriculum has been prepared and 11 training programmes conducted to train the 'trainers' who deal with PPPs in their domain.

Online Toolkits for PPP Projects: The PPP toolkit is a web-based resource that has been designed to help improve decision-making for infrastructure PPPs in India and to improve the quality of the infrastructure PPPs that are implemented in India. In the past one year, 720 national and international users have availed of this 'one-of-a-kind web-based resource to structure better PPP projects.

PPP Rules and PPP Policy: Following the recommendations of the 'Committee on Public Procurement', the transparency and accountability in procurement, preparation of the Public Procurement Bill, competitive bid process, affordability, and value for money, the draft PPP Rules and PPP Policy have been prepared – and have undergone extensive consultation process at central and state government levels for finalization.

Global experience indicates that PPPs work well when they combine the efficiency and risk assessment of the private sector with the public purpose of the government sector. They work poorly when they rely on the efficiency and risk assessment of the government sector and the public purpose of the private sector. India should be careful not to undertake PPPs that do not apportion risks and responsibilities sensibly. Moreover, flexibility needs to be built into arrangements so that the contract can be withdrawn and put up for rebid when the private party underperforms. The government needs to study the PPP experience and build some central capacity to help ministries, authorities, and states structure contracts and renegotiate troubled ones.

STATE DISCOMS

The government in September 2012 approved the scheme for Financial Restructuring of State Distribution Companies (Discoms). The salient features of the scheme are as follows:

i. 50 per cent of the outstanding short-term liabilities up to 31 March 2012 to be taken over by state governments. This shall be first converted into bonds to be issued by Discoms to participating lenders, duly backed by state government guarantee.

ii. Takeover of liability by state governments from Discoms in the next two to five years by way of special securities and repayment and interest payment to be done by state governments till the date of takeover.

iii. Restructuring the balance 50 per cent short-term Loan by rescheduling loans and providing moratorium on principal.

iv. The restructuring/reschedulement of loan is to be accompanied by concrete and measurable action by the Discoms/ states to improve their operational performance.

vi. The GoI will provide incentive by way of grant *equal to the value* of the additional energy saved by way of accelerated AT&C loss reduction beyond the loss trajectory specified under the RAPDRP and capital reimbursement support of 25 per cent of principal repayment by the state governments on the liability taken over by the state governments under the scheme.

ECONOMIC SURVEY 2012-13 ON INFRASTRUCTURE

The government document has provided the following inputs and advice in the area of India's infrastructure sector –

- The *12thPlan* lays special emphasis on development of the infrastructure sector including:
    - Energy, as the availability of quality infrastructure is important not only for sustaining high growth but also ensuring that the growth is inclusive.
    - The total investment in the infrastructure sector during the Plan, estimated at Rs. 56.3 lakh crore (approx. US$1trillion), will be nearly double that made during the 11th Plan.
    - This step up in investment will be feasible primarily because of enlarged private-sector participation that is envisaged.
- Unbundling of infrastructure projects, *public private partnerships* (PPP), and more transparent regulatory mechanisms have induced private investors to increase their participation in infrastructure sectors:
    - Their share in infrastructure investment increased from 22 per cent in the 10th Plan to 38 per cent in the 11th Plan and is expected to be about 48 per cent during the 12th Plan.
    - Yet, more than half of the resources required for infrastructure would need to come from the public sector, from the government, and the parastatals.
    - This would require not only the creation of the fiscal space but also use of a *rational pricing policy*.
    - Scaling up private-sector participation on a sustainable basis will require *redefining the contours of their participation* for the development of infrastructure sector in a

transparent and objective manner with a comprehensive regulatory mechanism in place.

- From a *macroeconomic perspective*, a high level of investment in the infrastructure sector is essential for the overall revival of investment climate which may finally lead to sustainable growth in an economy.
- However, in the current macroeconomic environment, to achieve this objective, there is need to address sector-specific issues over the mediumto long-term horizon in India.

- There is an *overall shortage of power* in the country both in terms of energy deficit and peak shortage:
  - At present, overall energy deficit is about 8.6 per cent and peak shortage of power is about 9.0 per cent.
  - The 11th Plan added 55,000 MW of generation capacity which was more than twice the capacity added in the 10th Plan.
  - The 12th Plan aims to add another 88, 000 MW.
  - Delivery of this additional capacity would critically depend on resolving *fuel* availability problems, especially when *about half* the generated capacity is expected to come from the private sector.
  - The private developers may not be able to finance the projects if *coal linkages* are not resolved and there are delays in finalization of fuel supply agreements (FSAs).
  - While some decisions have been taken for restructuring Discoms' finances, these may need to be monitored and implemented in spirit.
- Although India has large *coal* reserves, demand for coal is substantially outpacing its domestic availability, with Coal India Ltd. not being able to meet its coal production targets in the 11th Plan:
  - Domestic coal supplies are therefore *not assured* for coal-based power projects planned during the 12th Plan. Thus, it is essential to ensure that domestic production of coal increases from 540 million tonnes in 2011-12 to the target of 795 million tonnes at the end of the 12th Plan.
  - This increase of 255 million tonnes assumes an increase of 64 million tonnes of captive capacity with the rest being met by Coal India Limited.
  - However, even with this increase, there will be a need to import 185 million tonnes of coal in 2016-17 which may further add to the financing cost of power projects.
  - More effort must be made for improving competition and efficiency in the coal sector, which may entail structural reforms.
  - Problems like delays in obtaining environmental clearances, land acquisitions, and rehabilitation need to be suitably addressed in fasttrack mode to achieve the 12th Plan targets for coal production while maintaining a balance between growth needs and *environmental concerns*.
- Progress of *road* projects has also suffered on account of similar factors:
  - The creation of a High-Level Cabinet Committee on Investment to quicken the pace of decision making in critical infrastructure projects by the government is expected to

resolve any issues involving inter-ministerial coordination.

- Of late, financing of *road* projects has also run into difficulty as leveraged companies implementing road projects are unable to raise more debt in the absence of fresh equity. In current market conditions, these firms are unable to raise *new equity*.
- Exit route needs to be eased so that promoters can sell equity positions after construction, passing on all benefits and responsibilities to entities that step in.
- Promoters can then use the equity thus released for new projects.
- Steps are also needed to up-scale projects in PPP mode for achieving the targets envisaged for the development of roads in the 12th Plan.

• The process of extending *transparent policies* and mechanisms for allocation of scarce natural resources to private companies for commercial purposes has also been initiated:
  - The Mines & Mineral (Development and Regulation) Bill 2011 aims at providing a simple and transparent mechanism for grant of mining lease or prospecting licence through competitive bidding in areas of known mineralization and on first-in-time basis in areas where mineralization is not known.
  - *However*, in order to meet the objective of revenue maximization in an open, transparent and competitive manner, this should be preceded by detailed geological mapping of the mineral wealth of the country.
  - Further, any policy prescription regarding the use of natural resources must ensure that the process of selection is fair, reasonable, nondiscriminatory, transparent, and aimed at promoting healthy competition and equitable treatment.

• Owing to a number of external and internal factors, viability of *airline* operations in India has come under stress:
  - A high operating cost environment owing to high and rising cost of aviation turbine fuel (ATF) coupled with rupee depreciation is making operations unviable for carriers in India.
  - The Expert Report of Nathan Economic Consulting India Private Ltd. (Nathan India) which went into the question of pricing and the tax regime governing ATF concluded that ATF prices in India are significantly higher (at least 40 per cent) than in competing hubs in the region such as Singapore, Hong Kong, and Dubai.
  - Therefore, there is need to rationalize the tax regime particularly value added tax on ATF which is in the range of 20-30 per cent in most of the states.
  - The Ministry of Civil Aviation is of the view that ATF should be included under the declared goods category under the relevant provision of the Central Sales Tax Act so that a uniform levy of 5 per cent is achieved.
  - Equally important is the need for a transparent pricing regime for ATF in India. A high tax regime for aviation in general and ATF in particular will reduce the wider economic benefits available from aviation, resulting in a negative impact on economic growth and overall government revenue bases.

• The *Railways* is another urgent priority for the 12th Plan:

- Capacity in Railways has lagged far behind what is needed, especially given the requirement of shifting from road transport to rail in the interests of improving energy efficiency and reducing carbon footprints in development.
- The funding pattern of the Twelfth Plan clearly shows that the modernization of Indian Railways cannot be achieved by simply relying on GBS (Gross Budgetary Support) as about 62 per cent of the resources would have to be generated through non-GBS sources and nearly 20 per cent through private-sector investment.
- There is a need to draw up clear strategies to generate resources by identifying segments where Indian Railways can adopt a low-cost policy by playing on volumes and taking advantage of economies of scale and segments where it can adopt a differentiation approach by providing high quality services and command premium prices.

• The 12th Plan document, a GDP growth rate of about 8 per cent requires a growth rate of about 6 per cent in total *energy use* from all sources:
  - Unfortunately, the capacity of the economy to expand domestic energy supplies to meet this demand is severely limited.
  - The country is not well-endowed with energy resources, except coal, and the existence of policy distortions makes management of demand and supply more difficult.
  - Accordingly, the short-run action needed to remove impediments to implementation of projects in infrastructure, especially in the area of energy, includes ensuring fuel supply to power stations, financial restructuring of Discoms, and clarity in terms of the NELP.
  - At the same time, the long-term strategy should focus on issues like coal production, petroleum price distortion, natural gas pricing, and effective management of the urbanization process.

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1. Here this should be noted that India will be a planned economy, was well-decided before this industrial policy which articulated for an ***active role*** of state in the economy. The main objective of planning pointed out at this time was ***poverty alleviation*** by a judicious exploitation of the resources of the country. Only 'mixed economy' did fit such a wish (***Conference of State Industry Ministers, 1938***).
2. The nationalisation of industrial units allowed the government to enter the unreserved areas which consequently increased its industrial presence. Though the nationalisation was provided a highly rational official reason of ***greater public benefit,*** the private sector always doubted it and took it as an insecurity and major unseen future hurdle in the expansion of the private industries in the country.
3. The central government had always the option open to set up an industry in any of these 12 industrial areas. This happened in the coming years via two methods—first, the *nationalisation* and second, the *joint sector*.
4. Industrial Policy Resolution, 1956 (30 Oct.).
5. V.M. Dandekar, ***Forty Years After Independence*** in Bimal Jalan edited ***Indian Economy: Problems and Prospects,*** Penguin Books, N. Delhi, Revised Edition, 2004, p. 63.
6. The statement we get in the ***Second Five Year Plan (1956–61),*** too.
7. Bimal Jalan, ***India's Economic Policy,*** Penguin Books, N. Delhi, 1992, p. 23.
8. V.M., Dandekar, op.cit, p. 64.
9. These industries which were set up after procuring ***'licences'*** from the government had fixed upper limits of their production known as ***'quota'*** and they needed to procure timely 'permit' (i.e. permission) for the supply of the raw materials—that is why such a name to the whole system.

10. Such a commitment went completely against the *'theory of industrial location'*.
11. There were four specific committees set up on this issue, namely ***Swaminathan Committee (1964), Mahalanobis Committee (1964), R.K. Hazari Committee (1967)*** and ***S. Dutt Committee (1969).*** The Administrative Reform Commission (1969) did also point out the short comings of the industrial licencing policy perpetuated since 1956.
12. ***Dutt Committee,*** 1969.
13. The upward revision was logical as it was hindering the organic growth of such companies—neither the capacity addition was possible nor an investment for technological upgrading.
14. Out of the six core industries only the cement and iron & steel industries were open for the private investment with the rest fully ***reserved*** for the central public sector investment.
15. This is considered a follow up to such suggestions forwarded by the ***Industrial Licensing Policy Inquiry Committee*** (S. Dutt, Chairman), Government of India, N. Delhi, 1969.
16. The FERA got executed on January 1, 1974. The private sector in the country always complained against this act and doubled its official intention.
17. This limited permission was restricted to the areas where there was a need of foreign capital. Such MNCs entered the Indian economy with the help of a partner from India—the partner being the major one with 74 per cent shares in the subsidiaries set up by the MNCs. The MNCs invested via ***technology transfer route.*** Basically, this was an attempt to make up the loss being incurred by the FERA. This was the period when most of the MNCs had the chances to enter India. Once economic reforms started by 1991, many of them increased their holdings in the Indian subsidiaries with the Indian partner getting the minority shares or a total exit.
18. The permission of working was withdrawn in the case of already functioning soft drink MNC the ***Coca Cola.*** The ongoing process of entry to the computer giant ***IBM*** and automobile major ***Chrysller*** was soon called off. These instances played a highly negative role when India invited the foreign direct investment in the reform era post-1991.
19. A total number of 95 industries had the compulsions of licencing till then. These industries belonged to Schedules B and C of the Industrial Policy Resolution, 1956.
20. This was similar to the policy being followed by Gorbachev in the USSR with the similar fiscal results—a severe balance of payment (BoP) crisis by end 1980s and the early 1990s (Rosser & Rosser, ***Comparative Economics in A Transforming World,*** PHI & MIT Press, N. Delhi, 2004, pp. 469–75).
21. The ***Seventh Five Year Plan (1985–90)*** as well as the ***Sixth Five Year Plan (1980–85)*** had already suggested the Government to re-define the role of state in the economy and permit the private sector into those areas of industries where the presence of the Government was non-essential, etc. But such a radical approach might not be digested by the country as it was like 'rolling back' the state. This is why the Government of the time looks not going for full-scale economic reforms or vocal moves of the liberalisation.
22. Vijay Joshi and I.M.D. Little, ***India's Economic Reforms, 1991–2001,*** OUP: Clarendon Press, London, 1996, p. 17.
23. ***Economic Survey, 1990–91 & 1991–92,*** N. Delhi. GOI, MoF.
24. Sach, Varshney and Bajpai, op.cit., p. 2.
25. ***'Economic Reforms: Two Years After and the Task Ahead',*** Discussion Paper, Ministry of Finance, Department of Economic Affairs, GoI, N. Delhi, 1993, p. 6.
26. Ibid.
27. Bimal Jalan, ***India's Economic Crisis: The Way Ahead,*** OUP, Delhi, 1991, p. 2–12.
28. Sach, Varshney and Bajpai, op.cit., p. 2.
29. Rakesh Mohan, ***Industrial Policy and Controls*** in the Bimal Jalan edited, ***The Indian Economy: Problems & Prospects,*** op.cit., p. 92–123.
30. In 1985–86 there were just 64 industries under the compulsory licencing provision. By the fiscal 1996–97 the number remained six (Economic Survey, 1996–97 GoI, N. Delhi.). Though the numbers are still six, all these six industries have many internal areas which today carry no obligation of licencing. As for example, the electronic industry was under this provision and entrepreneurs needed licences to produce radio, TV, tape-recorder, etc., what to ask of mobile phones, computers, DVDs and i-pods. Now only those electronic goods carry licencing provision which are related to either the aero-space or the defence sectors—thus we see a great number of electronic industries freed from the licencing provision the item 'electronics' still remains under it. Similarly while 'drug & pharma' still belong to the licenced industries, dozens of drugs and pharmaceuticals have been made free of it. The six industries have gone for high level internal de-licencing since the reforms started.
31. ***Economic Survey, 1994–95,*** GoI, N. Delhi.
32. It becomes very complex and tough to regulate the individual foreign investment in the share market though it is an easier way of

attracting foreign exchange. It should be noted that the South East Asian economies which faced financial crisis in 1996–97 all had allowed individual foreign investment in their share market. As the Indian security market was learning the art of regulation in its nascent phase, the government decided not to allow such foreign investment. The logic was vindicated after the S.E. Asian currency crisis when India had almost no shocks ***(Economic Survey, 1996–97,*** GoI, N. Delhi***).***

33. The delayed action by the government in the foreign exchange liberalisation was due to the delayed comfort the economy felt regarding the availability of foreign exchange.

34. This was another hurdle which the private sector industries have been complaining about. As the industrial products were completely new to the Indian market and its consumers alike, the government followed this policy with the logic to provide enough time so that the products become domesticised i.e.development of awareness about the product and its servicing, maintenance, etc. As for example the MNC subsidiary Phillips India was allowed to produce a highly simple radio ***Commandar*** and ***Jawan*** models for comparatively longer periods of time then they were allowed to come up with the smaller fashionable radio sets or two-in-ones and three-in-ones. Such provisions hampered their full capacity utilisation as well as achieving the economy of scale had also been tougher. The new industrial policy of 1991 did away with such impediments. By that time, the Indian consumer as well as the market was fully aware of the modern industrial goods.

35. Combined with nationalisation, this ***indirect route*** to nationalisation failed to provide the confidence among the entrepreneurs that the industrial units they are intending to set up will be owned by them. This discouraged the entrepreneurship of India while taking risk. The abolition of this compulsion was an indirect indication by the government of no more direct or indirect nationalisation in future. This has served the purpose, there is no doubt in it.

36. This nexus of the interests of the vested groups to the control regime of the economy has been beautifully elaborated by **Rakesh Mohan** in ***Industrial Policy and Controls*** in the **Bimal Jalan** edited ***The Indian Economy: Problems & Prospects,*** op. cit. pp. 92–123. He also points out that the control system perpetuating the academic and intellectual ideological leanings negated the very need for re-examination of the system. The 'planners' and the 'bureaucrats' were able to preserve their powers via the control regime did everything to maintain the status quo, Rakesh Mohan further adds.

37. First of the series of such suggestions came from **Sach, Varshney and Bajpai** (eds.) ***India in the Era of Economic Reforms,*** OUP, op. cit., p. 24).

38. It should be noted that ***'reform with the human face'*** was not a new slogan or call given by the UPA Government but this was the same slogan with which the reform programme was launched by the Rao—Manmohan Government in 1991—it has only been 're-called back' by the new Government with a new committment to live it up.

39. Point should be noted that **Bharat Niraman** has been the only time-bound programme of infrastructure building in rural areas which is supposed to be completed within the four years (the time left out of the total term of the Government when the programme was launched). The UPA naturally, tries to make it a political statement and a point for next General Elections—development becoming an issue of real politics! Let's see what happens.

40. ***India 1991,*** Pub. Div., GoI, N. Delhi.

41. The de-reservation of industries had allowed the private sector to enter the areas hitherto reserved for the Central Government. It means in coming times in the unreserved areas the PSUs were going to face the international class competitiveness posed by the new private companies. To face up the challenges the existing PSUs needed new kind of technological, managerial and marketing strategies (similar to the private companies). For all such preparations there was a requirement of huge capital. The government thought to partly fund the required capital out of the proceeds of disinvestment of the PSUs. In this way disinvestment should be viewed in India as a way of increasing investment in the divested PSUs (which we see taking place in the cases of BALCO, VSNL, etc.).

42. Right since 1991 when disinvestment began, the total governments have been using the disinvestment proceeds to fulfill the fiscal deficits in every budget at least up to 2000–01. From 2000–01 to 2002–03 some of the proceeds went for some social sector works or labourer's security. After 2003 India has a National Investment Fund to which the proceeds of disinvestment automatically flow and is not supposed as a ***capital receipt*** of the Union Government. This idea of Indian experiment with disinvestment was articulated by ***Sach, Varshney and Bajpai,*** op.cit., p. 62–63.

43. As was done by **Margaret Thatcher** in the UK in the mid-1980s. Her brand of privatisation was driven by the conviction that government control makes PSUs inherently less efficient and privatisation therefore improves its economic efficiency and is good for the consumers. However, this idea has been rejected around the world on the empirical bases. ***A PSUs could also have comparable economic efficiency even being under the full government control.*** This was followed by Mrs. Thatcher (1979–90) forcefully in Great Britain conjoined with the supply-side economics as was done by Ronald Reagan (1981–89) in the United States as discussed by **Samuelson and Nordhaus** in ***Economics,*** op.cit., p. 703.

44. A highly experienced person from the media world, Arun Shourie remained the Minister for the whole term of the NDA government. Some highly accelerated and successful disinvestments were done during this period but not without the controversies.

45. ***Concept Classification of the PSEs,*** Government of India, 16.03.1999.
46. **India 2003**, Pub. Div., GoI, N. Delhi.
47. Ministry of Finance, Deptt. of Disinvestment, GoI, N. Delhi, ***Disinvestment Policy Announcement,*** Nov. 5, 2009.
48. Various issues of ***Economic Survey,*** GOI, N. Delhi.
49. It was proposed by Yashwant Sinha and thus got popularity as the ***'Yashwant Formula'*** of using disinvestment proceeds. Being his personal proposal, the Government of the time was not officially bound to it. However, the idea got support inside and outside of the Parliament and looked having an impact on the government's thinking about the issue.
50. Ministry of Finance, Deptt. of Disinvestment, GoI, N. Delhi, ***Disinvestment Policy Announcement,*** Jan. 27, 2005.
51. Ministry of Finance, Deptt. of Disinvestment, GoI, N. Delhi, ***Disinvestment Policy Announcement,*** Nov. 5, 2009.
52. ***Ministry of Finance,*** GoI, March 16, 2012, N. Delhi & the ***Economic Survey 2011-12,*** op.cit.
53. ***Economic Survey 2012-13,*** *op.cit., p. 203.*
54. *For a detailed discussion see* ***Chapter - 21***, p. 21.12.
55. ***Ministry of Statistics & Programme Implementation,*** May 10, 2011, GoI, N. Delhi.
56. ***Economic Survey 2011-12,*** op.cit., pp. 212-213.
57. ***Economic Survey 2012-13,*** op.cit.
58. ***Oxford Dictionary of Business***, N. Delhi, 2004.
59. ***India Infrastructure Report, 1994,*** GoI., N. Delhi.
60. One of such major suggestion was forwarded by ***Jeffrey D. Sach, Ashutosh Varshney*** and ***Nirupam Bajpai*** (Eds.) in ***India in the Era of Economic Reforms,*** OUP, N. Delhi, 1999, p. 79.
61. ***Economic Survey, 2006–07,*** GoI, N. Delhi.
62. ***India Infrastructure Report 2007,*** GoI, N. Delhi.
63. ***Mid Term Appraisal of the 11th Pan,*** Planning Commission, GoI, N. Delhi, released Oct. 2011.
64. ***Planning Commission,*** while announcing the *Approach for the 12th Plan,* N. Delhi.
65. ***Approach to the 12th Plan,*** Planning Commission, GoI, N. Delhi.
66. Analyses on the sectoral situations in the infrastructure sector of India and the new initiatives taken by the GoI in recent times are based on the Governments documents – ***Economic Survey 2011-12,*** op. cit., pp. 251-276; ***Approach Paper to the 12th Plan,*** op. cit.; ***Mid Term Appraisal of the 11th Plan,*** op. cit.; various ***Papers*/Documents** published by the ***Planning Commission;*** and different ***Releases*** by the concerned ***Central Ministries of the GoI.***

10

INDIA AND THE GLOBAL ECONOMY

*'India arrives on the global stage'.......world concluded at the World Economic Forum, Davos, Switzerland..... in any discussion of India's economy, China is an almost inevitable subtext. With its high-rise cities, new airports, modern highways, and fantastic growth – exceeding 9 per cent for the past three years – China sends a clear message to the world of progress and power. The country's singular focus on economic development has been shaped by top-down government control that extends into ownership of most major enterprises. By contrast, India touts its open society and 'messy', yet functioning, market-based democracy as a more conducive environment for long-term development. Its Western-style legal system and transparent financial systems encourage a chaotic, bottom-up approach to growth. India is one of the world's greatest experiments – the challenge is to lift a huge percentage of humanity out of poverty, and to do it in the context of a very freewheeling and open democracy – it could be a huge example for the world.**

- An Introduction
- Global Economy Today
- Eurozone Crisis
- Changing Dynamics
- Locating India
- The Path to Revival
- Prospects for India

* Excerpted from Julia Hanna, *Harvard Business School Alumni Bulletin,* Harvard, USA, 5th June 2006.

AN INTRODUCTION

India's involvement with the global economy got a completely new dimension in 1991 when it committed it self to the cause of the economic reforms. The involvement went on increasing with the every passing year. The corporate class who were the most concerned lot regarding economic reforms in 2001 requested the GoI to accelerate the process of reforms, via a memorandum, by that the industry and trade had enough proofs that the ongoing process of reform was better for them. We see the dynamics of world economy taking a shift once the provisions of WTO got implemented. To be precise, once the process of globalisation commenced in the 'defined terms' (defined by the WTO), India's involvement with the global economy again increased to a new level. By 2000, IMF/WB, together with the credit rating agencies had started terming India the 'next BIG economic happening' – having the potential of emerging as 'the biggest economy' of the world. Once most of the advanced economies crash-landed after ongoing financial crisis, especially in Eurozone, India was declared almost the 'last hope' for the global economy (China was also seen in the same light but with a caution due to its non-democratic polity) – this can be seen as the arrival of India on the global scale – emerging as one of the most important member of the present global economy – now experts say that India has every potential to play a very vital role in the 'global economic order' which will emerge tomorrow!

Looking at the global importance of the Indian economy the current Economic Survey (2011-12) has added a new chapter to it with the title – *India and the Global Economy* – the very introductory lines[1] of the chapter looks like a celebration of the ***India Story*** – "The big story of the last decade for India has been its arrival on the global scene. The Indian economy had broken free of the low-growth trap from the early 1980s. By the mid-1990s, following the economic reforms of 1991-3, India began to appear as a player of some significance in the global economy. Then, following the East Asian crisis of the late 1990s, and from the first years of the first decade of the 21 st century, there was no looking back. India's exports began to climb, its foreign exchange reserves, which for decades had hovered around 5 billion dollars, rose exponentially after the economic reforms and in little more than a decade had risen to 300 billion dollars. Indian corporations that rarely ventured out of India were suddenly investing all over the world and even in some industrialized countries. When, in 2009, the Group of 20 (G-20) was raised to the level of a forum for leaders, India was a significant member of this global policy group."

As the enhanced process of globalisation came with new opportunities to India, it has also brought with it new challenges and responsibilities. Now, India can no longer view the global economy from a spectator's standpoint which it means that the happenings in the global economy have large implications for India. Now, every time there is a major financial crisis in the world, it has an impact on India and her growth prospects.

To give the 'real feel' of the issue this chapter of the book has been titled as the Survey titles it (it looked futile to go for more jargonised and less comprehensive titles). The chapter systematically examines[2]:

(i) the state of the global economy and India's position therein;

(ii) the current global slowdown and their implications for India and the policy challenges that

these issues give rise to the domestic economic environment; and

(iii) India's role as a constructive player in the evolving global order in light of the G-20

GLOBAL ECONOMY TODAY

Economic developments throughout 2011were not encouraging in major economies of the world – experts have apprehensions that the process of global economic recovery that began after the financial crisis of the 2008 is beginning to stall and the sovereign debt crisis in the eurozone may persist for a while. There is an effort to build *firewalls* around these danger zones, but the world has *little experience* with this; so we need to be prepared for breaches in the walls (the last experience, in 1929, of the Great Depression was not of the similar kind). We may sum up the economic situation of the world econmy by taking clues from the informations[3] given below:

(a) Recent data from the US economy show a revival and is projected to maintain its growth rate at 1.8 per cent for 2012 – economic growth in the US remains sluggish despite extensive use of both fiscal and monetary policy tools which has been a matter of concern for the whole world.

(b) The euro zone is expected to contract by 0.5 per cent in 2012

(c) The global economy is expected to grow by 3.3 per cent in 2012 compared to 3.8 per cent in 2011 as per the IMF's **January 2012** update of the *World Economic Outlook (WEO)*.

(d) GDP growth in advanced economies declined to 1.6 per cent in 2011 compared to 3.2 per cent in 2010 and is expected to be even lower at 1.2 per cent in 2012 (IMF).

(e) Growth in emerging economies slowed to 6.2 per cent in 2011 compared to 7.3 per cent in 2010 and is projected to be 5.4 per cent in 2012 (IMF).

Reason of the Crisis

Predominant reason for the subdued growth in advanced economies at this juncture remains the sovereign debt crisis that started in the peripheral economies of the euro zone, but from the latter half of 2011, started to adversely affect the major economies there, as well. The exposure of European banks to public and private debt, issues relating to medium-term fiscal consolidation, and lack of consensus as how to resolve the crisis have continued to weigh on the global economic outlook as the eurozone accounts for close to ***20 per cent*** of global GDP.

Capital flows volatility resulting from the spillover effects of monetary policies followed by the advanced economies further affected the exchange rates and made the task of macroeconomic management difficult in many emerging economies; which is giving rise to a *new dimension of globalisation* in the post financial crisis world, where easy monetary policy in one set of countries may result in inflation elsewhere due to cross-border capital flows[4].

Unemployment Scenario

Situation of unemployment in advanced economies in general, and the peripheral economies of the

eurozone in particular has not improved (which deteriorated in the wake of the global crisis). The OECD Employment Outlook 2011 observed that[5]:

(a) with the recovery stalling, OECD unemployment remained high, with close to 44.5 million persons unemployed.

(b) the extent of unemployment has been varied across OECD countries, with Spain exhibiting the highest unemployment rate (21.7 per cent).

(c) the main losers have been youth and temporary workers, some of whom have been getting out of the job market.

(d) the US has shown some improvement (8.7 per cent in 4th Quarter, 2011 compared to 9.1 per cent in 3rd Quarter, 2011), but nevertheless remains high.

The persistently high rates of unemployment in advanced countries, especially in the crisis-affected countries of the eurozone, the ***inherent contradiction*** of fiscal consolidation is having a social fallout in the peripheral economies and has sharply polarized public debate fon the appropriate economic policies to be adopted.

EUROZONE CRISIS

The eurozone, a currency union of 17 European countries, has been going through a major crisis[6] which started with Greece but spread rapidly to Ireland, Portugal, and Spain and subsequently Italy. Sparked off by fear over the sovereign debt crisis in Greece, it went on to impact the peripheral economies as well, especially those with over-leveraged financial institutions. These economies, especially Greece, have witnessed downgrades in the ratings of their sovereign debt due to fears of default and a rise in borrowing costs. The sovereign debt crisis has made it very difficult for some of these countries to re-finance government debt. The banking sector in these countries also stands adversely affected.

Good Experiment: After the euro was launched, the eurozone witnessed not only a decline in long-term interest rates (especially from 2002 to 2006), but an increasing degree of convergence in the interest rates of member countries. A common currency, similar interest rates, and relatively strong growth provided a basis for a rise in public and private borrowing with cross- border holdings of sovereign and private debt by banks. Those were the good times for the eurozone

Crisis Triggered: In the aftermath of the global financial crisis in 2008, sovereign debt levels started to mount. The revelation that the fiscal deficit in Greece was much higher than stated earlier set off serious concerns in early 2010 about the sustainability of the debt. The downgrade of ratings led to a spiral of rising bond yields and further downgrade of government debt of other peripheral eurozone economies as well, that had high public debt or a build-up of bank lending or both.

Spread: Concerns intensified in early 2010 as cross-border holdings of sovereign debt and exposure of banks came to light. The financial markets quickly transmitted the shocks which not only led to a sharp rise in credit default swap (CDS) spreads but later impacted capital flows elsewhere.

The underlying weaknesses of the zone have made it difficult to resolve the crisis:

i. The eurozone lacks a single fiscal authority capable of strict enforcement;

ii. Economies with different levels of competitiveness (and fiscal positions) have a single currency;
iii. These economies cannot adjust through a depreciation of the currency;
iv. There is no lender of last resort, i.e. a full-fledged central bank (as is RBI in India and other economies).

Remedy: European finance ministers, in May 2010, agreed on a rescue package worth Euro 750 billion to ensure financial stability by creating the *European Financial Stability Facility (EFSF).* In October 2011, the eurozone leaders agreed to a package of measures that included an agreement whereby banks would accept a 50 per cent write-off of Greek debt owed to private creditors an increase in the EFSF to about Euro1 trillion and requiring European banks to achieve 9 per cent capitalization. The date for this package was brought forward to July 2012. To restore confidence in Europe, EU leaders also agreed to a fiscal compact with a commitment that participating countries would introduce a balanced budget amendment. In December 2011, the European Central Bank (ECB) took the step of offering a three-year long-term refinancing operation (LTRO) at highly favourable rates to alleviate funding stress which helped bring down the yields somewhat during January and February 2012. But overall uncertainty about the effectiveness of all these measures and how further resources would be raised, their adequacy, and doubts about sovereign debt levels coming down remain there. Due to low-growth scenario, the ability of Greece and other economies to undertake further fiscal austerity remains a big matter of concern for the world.

Eurozone and India: Though distinct from the European Union (EU), the Eurozone is its major subset. The eurozone and EU account for about **19** and **25** percent of global GDP, respectively. The EU is a major trade partner for India accounting for about **20** per cent of India's exports and is an important source of foreign direct investment (FDI). The IMF has forecast that the eurozone is likely to go through a *mild recession in 2012.* A slowdown in the eurozone is likely to impact the EU and the world economy as well as India.

The sluggish revival of global growth in 2011 came on top of disruptions in supply-chain networks resulting from the devastating earthquake and *tsunami in Japan* (in March 2011). Later in the year (October and November), severe *flooding in Thailand* also disrupted some supply chains. Political uncertainties in some Middle East and North African countries have been another source of uncertainty apart from their obvious *implications for oil prices.* The severe uncertainty in the eurozone impacted the global financial markets leading to capital reversals to safe havens in December 2011. Global economy, at this juncture, in the short run, is being threatened by multiple shocks emanating from various sources, economic, social, and geopolitical. The lower global growth forecast by the IMF for most countries in 2012 *perhaps* reflects the repeated cycles of uncertainty arising from these diverse sets of factors.

India is, nevertheless, projected to be the **second-fastest-growing** major economy (7 per cent) after China (8.2 per cent) as per the IMF. In the medium term, challenges for the global economy continue to emanate from the way the eurozone crisis is addressed. The high deficits and debts in Japan and the United States and slow growth in high income countries in general, have not been resolved. The looming risk to the global outlook is also on account of the geopolitical tensions centred on Iran that could disrupt oil supply and result in a sharp increase in oil prices and even disrupt supply routes.

While the current conjuncture is important for anticipating outcomes in the short to medium term, the

current global situation is also a manifestation of certain long-term developments and changes in the relative positions of the major economies that have now perhaps reached certain critical proportions.

CHANGING DYNAMICS

The global economy has gone for a big change in its dynamics over the last two decades and this process has every potential to further the change in coming years and may be for decades to come. The shares of major economies in global GDP, manufacturing, and trade —a few traditional tools of assessing global economy—suggest that there has been a marked change in the configuration of the world economy (especially over the last decade). Over the last 20 years, sustained growth of a number of emerging economies, especially the BRICS economies, has resulted in an increase in their share in the global GDP. As a consequence, the value addition in the world economy has been moving away from advanced countries towards what have been termed emerging economies. The decline in share is particularly marked in the case of the EU. The shift towards Asia has been significant and, within Asia, away from Japan to China and India. The *fivefold* increase in share of China in the global GDP has placed it as the second largest economy in the world. The increase in share of India, though less dramatic, is nevertheless of an order that places her as the ***fourth*** largest economy in PPP terms[7].

The reduction in share of advanced economies, particularly from 2005, has been accentuated by the slowdown that followed the 'sub-prime crisis' in the United States, the eurozone crisis in 2010, and the near stagnation in Japan for nearly two decades on the one side and the significantly higher rate of growth in low and middle income countries, particularly the large countries like India and China, on the other.

From the perspective of whether there has been a 'catch up' (or convergence) in per capita incomes across a larger set of countries, it is seen that the standard deviation of per capita income (at PPP constant 2005 dollars) of 131 countries from 1980 to 2009 continued to increase for most of the period since the mid-1980s (indicating divergence rather than convergence), except in the last two-three years[8]. This indicates that despite a reduction in the share of advanced countries, the inequity between the developed and developing countries might have increased for most of the time period. Whether the recent reduction in standard deviation is associated with the 'catching up' process of countries (including low income countries), or a slowing down of developed countries following the financial and economic crisis, and whether this is likely to be a temporary phase are issues that need further investigation.

The foregoing dimension of ***inequality*** does not capture interpersonal inequality. According to a study based on consumption data undertaken by Branco Milanovic of the World Bank, global inequality has been quite high, with the bottom 50 per cent of the people accounting for only 6.6 per cent of world income/consumption on PPP basis in 2005 while the top 1 per cent accounted for 13.4 per cent and top 10 per cent for as much as 55 per cent.

As far as **India** is concerned, it has achieved faster growth from the 1980s. Not only was this growth higher compared to its own past, it was also much faster than that achieved by a large number of countries. Between 1980 and 2010, India achieved a growth of 6.2 per cent, while the world as a

whole registered a growth rate of 3.3 per cent. As a result, India's share in global GDP, (measured in terms of constant 2005 PPP international dollars) more than doubled from 2.5 per cent in 1980 to **5.5** per cent in 2010. Consequently, India's rank in per capita GDP showed an improvement from 117 in 1990 to 101 in 2000 and further to 94 in 2009, out of 131 countries. China improved its rank from 127 to 74 during the same period. Underlying the relative decrease in share of advanced economies in the global GDP, there has been a marked shift in the *location of manufacturing.* This process was on in the 1990s too but got accelerated in the current decade. Again, the rise in share of China is particularly significant while other emerging economies, namely Brazil, India, Indonesia have also moved up in terms of their share in world manufacturing value added. Even with the change in distribution of global GDP and manufacturing across countries, it needs to be noted that the advanced countries still account for a large share of industrial output apart from being the repositories of technology and value added in services.

World Trade

The changes in distribution of manufacturing, to some extent, get reflected in the relative shares in world *merchandise trade*[9] (which also includes non- manufactured products). Again, there is a perceptible decline in the share of developed countries and rise in the importance of emerging economies, most significantly China. The share of India in global merchandise exports increased from about 0.5 per cent in 1990 to **1.5** per cent in 2010. Yet India's share remains miniscule and it ranks 19th in the global order of exporting countries.

Even in *service exports,* the high income countries have witnessed a declining share but they continue to account for an overwhelming **79** per cent of global service exports[10]. While India, by virtue of its information technology (IT) industry, has seen its share of service exports rise to 3.3 per cent, China has moved in from behind and now accounts for 4.5 per cent.

Financial services play a major role in some of the developed economies and, of the top 10 financial centres, most are located in advanced markets[11]. This is reflected in exports as well as imports and India figures in the top ten both as an exporter of financial services with a share of 2.4 per cent and an importer with a share of 6.7 per cent. *In general, the foregoing distribution of economic activities and trade has a bearing on where nations stand in terms of their position on various issues that get discussed in major economies global forums.*

Demographics

The role of demography in shaping the size of the labour force and economic productivity and its structure has a bearing on economic growth. As compared to the 1980s, it is clear that a number of advanced countries have ageing populations. At the same time, their share in the global GDP is reducing in relative terms. The changing *dimensions* of the world demographics and the critical role the *international migration* plays become visible via the UN Population Division[12] which is as given below:

1. Of the 6.9 billion global population in 2010, 214 million or **3.1** per cent were international migrants.
2. South-South migration is also becoming important about which sufficient data is not available.

3. Without international migration, the working-age population (persons in age group 20-64 years, as per UN classification) in the developed countries would decline by 77 million or about 11 per cent – which could increase the dependence of the developed countries on international migrants or on outsourcing of work.
4. While demographic changes are incremental, the cumulative change in demographic structure has started to impinge on the **fiscal capacity** of many developed economies, particularly in Europe – an increase in share of *retirees,* existing social compacts in many developed countries have come under strain as their capacity to service ***public debt*** has diminished and private debt has also risen.
5. The recourse to automatic stabilizers during the financial crisis has stretched their fiscal capacity as public debt in relation to GDP has reached close to or exceeded the benchmark of 100 per cent of GDP and, in case of Japan, touched a whopping **220** percent of GDP[13].
6. An interesting point to note is that as compared to most of the major economies, expenditure of the general government in **India** is much lower as is the case in respect of revenue.

At this juncture, there is an underlying ***resistance*** on both counts in advanced economies that may well make the revival of growth more challenging. With regard to economies like India, the availability of a larger proportion of working-age population is likely to play a central role in driving economic growth. As the dependency falls, opportunities for economic growth tend to rise, creating what is termed as a *'demographic dividend'.*

Till conscious action is put in place (discussed in the chapter *'Preparing for the Demographic Dividend'*), the 'dividend' will not start accruing automatically in India's favour. The prospects can be increased by India's timely and needful actions.

Current Account and Forex Reserves

In response to a series of financial crises, especially after the East Asian crisis of 1997, many emerging and developing economies adopted new strategies for managing their external economy. These involved greater reliance on exports (aimed at current account surpluses) and the accumulation of foreign exchange reserves, in part to check currency appreciation and also as self-insurance against capital flow outflows/reversals (of the FDI and the PIS in India's case). These strategies led to a shift from being net importers of financial capital to net exporters. As reserves got invested in developed economies, it led to a *contradictory phenomenon* of capital flowing from emerging countries to capital-rich countries (especially the US). In an accounting sense, this was equated to high saving rates in the emerging market economies (EMEs), especially *China* which was sitting on a current account balance of over US $ 300 billion *(as per the latest data provided by the WEO)* and a Forex reserves above **US $ 2800 billion.**

In this regard, **India,** is somewhat a different case. While holding substantial forex reserves (US $ 295.6 billion[14]), it has essentially had a *structural current account deficit* and is therefore not a contributor to global imbalances in the foregoing sense. Regardless of the merits of holding forex reserves, it is by now agreed that the relatively stronger external financial position (forex reserves) of the EMEs made them less vulnerable to the capital outflows/reversals following the global financial crisis of 2008 and in that sense a *vindication* of the strategy of maintaining high reserves.

High buid-up of current account surpluses and forex reserves have been **a matter of global debate** among the financial experts, central banks and the policy-makers. The pros and cons of it may be seen in the following way, especially, in the light of the ongoing global financial crises:

(i) While holding forex reserves has been acknowledged to be useful in dealing with the crisis, it has also been argued that excessive reserves involve (quasi-fiscal) costs apart from yielding low returns as countries invest abroad rather than in high-return domestic investments.

(ii) Furthermore, large fluctuations in the exchange rate could result in significant losses in its value (for example, if the US dollar weakens, it could result in a loss in value of forex reserves denominated/maintained in the currency).

(iii) Apart from the holding costs to the economy, high build-up of current account surpluses and reserves has been seen as a major indicator of global imbalances and potential source of instability in the international monetary system.

(iv) In the global context, it has been argued that reserve accumulation was an outcome of resisting currency appreciation and an attempt to stimulate export-oriented production at the expense of domestic demand.

(v) The reserve accumulation by key emerging current account surplus economies, mostly held as dollar assets, supported a strong US dollar in spite of a growing current account deficit in the US. By thwarting exchange rate adjustment, this practice has been contributing to global economic imbalances.

(vi) On the other hand, it has also been argued that the build-up of reserves is a consequence of loose monetary policies followed by reserve currency-issuing countries.

There may be divergent opinions on the positives and negatives in this case, the fact remains that the issue of exchange rate management, build-up of current account surpluses and of reserves cannot be viewed in isolation and these issues are embedded in a wider ongoing debate on the deficiencies of the *international monetary* and *financial system.*This is why there has been a strong demand for reforms in the IMF (which looks after the International Monetary System), especially, from the emerging economies which now seems logical to the advanced economies, too. But for the time being, the global economy has to learn the ways and means to operate amidst the high buid-ups of the current account surpluses and forex reserves which are kept/maintained by the EMEs.

Savings and Investment

One of the features of the 'new normal' in the world economy is the way savings as well as investment rates are distributed between the advanced and emerging economies. As per the database of the WEO, the most advanced economies have gross saving rates *below 20 per cent* while the opposite is true of the EMEs; in case of China it is around 52 per cent, for example. **India's** investment rates, for example, have risen some 12 percentage points of GDP from the mid-1990s to around 35.1 per cent in 2010-11 *(Economic Survey 2011-12).* Investment trends drive growth and the divergence seen in savings is almost symmetrically reflected for the investment rates.

Implications of the Change

The changes in composition/dynamics of the global economy discussed thus far suggest a perceptible

shift in the global balance of output of goods (especially manufacturing). While services (in particular financial services) continue to be largely concentrated in advanced economies, a larger share in world population, coupled with higher growth, implies that the EMEs and developing countries will increasingly account for incremental growth in the global market for goods, services, and commodities. A change in the global economic balance driven by supply and demand forces therefore appears to be the **'new normal'** and is likely to accentuate in the years to come, as has been discussed by the experts in following paragraphs:

(a) In the situations when small economic crises crop up repeatedly over a relatively short period of time, policymakers in each country may treat each such episode as an independent event requiring independent action but in reality such 'cluster crises' may be a sign of some fundamental shift taking place in the global economy. Hence, faced with cluster crises, it is important to occasionally step back and take a more holistic view of the situation. There has been some research trying to do precisely that.

(b) It does not seems too difficult to see what is happening, at one level – with rapid globalisation since the end of World War II, goods and services and also capital have begun moving much more freely across nations. The advance of IT has meant that it is possible for people with a modicum of skills to sit in one country and do work for another country – this adds a new dimension to the situation. Briefly saying, one of the most precious resources for economic progress, namely ***skilled labour,*** which earlier sat walled in within the boundaries of their respective nations, has suddenly become available to needs arising in distant parts of the world.

(c) As a result of all this, all emerging economies with a little ability to organise their workspace and impart skills to their workers are now capable of taking advantage of this windfall. The bottom end of the skilled-labour spectrum in the US and Europe now faces competition from the top end of the skilled labour band of India, China, the Philippines, Indonesia, and several other emerging economies. This has energised large corporations in rich and poor countries and caused booms in various regions, like *Silicon Valley* in the United States. But this is also causing inequality to rise in both industrialised nations and emerging economies.

(d) A recent paper[15] highlights how this process is one of the causes of growth and employment trends, within the US economy diverging and inequality rising. And 'the major emerging economies are becoming more competitive in areas in which the U.S. economy has historically been dominant, such as the design and manufacture of semi-conductors, pharmaceuticals and information technology services'. By the same argument the skilled end of the labour markets in India and China is competing with its counterparts in industrialised nations and, as a consequence, its salaries are rising, resulting in growing inequality in these countries.

Inter-country tensions have been building up in the other domains, too, disparities in ***savings rates*** across nations have often led to acrimonious debate and search for first cause. It has been suggested[16] that China's huge savings rate may not be entirely because of domestic structural factors in China but a response to the fact that the savings rate in the U S dropped sharply between 1960 and 2010.

The above-discussed adjustments/changes/shifts give rise to economic turmoil and crisis and, in addition, are politically sensitive matters that can lead to protectionism, which can do more harm than

good. It is important for us to recognize that none of these structural shifts are caused by the actions of any one individual or nation. Millions of little actions and thousands of scientific discoveries over decades and human inventiveness in general have given rise to globalization and we have inherited the world we have. It is for us to take the givens as given and use collective bodies such as the G-20 to ensure that we do not fall victim to *protectionism.* It is important to remember that through all this turmoil the global pie/opportunities *(basically, due to the ongoing process of globalisation about which even the developing nations have no doubt who questioned its very rationale while the WTO was in the process of emergence, i.e. 1985-1994)* is expanding. Hence, by having effective coordinated action, it is possible to convert what appears at first as adversity into advantage.

Presently, we see very high levels of private consumption and government expenditures (in relation to their GDPs) among the advanced economies. In such case, a *prolonged slowdown* could place further pressure on their budgetary balances and household savings (that are already low) and adversely impact investment and their potential growth. Thus the possibility of low growth setting off a vicious cycle of ***higher debt*** and ***low growth*** cannot be ruled out.

This is why, even when the emerging economies (including India) witnessed a slowdown in growth in 2011 due to the renewed bouts of uncertainty in the global economy, there are reasons to suggest that the growth prospects of most of these economies remain robust in the medium to long run – due to various factors that drive growth such as[17]:

(i) demographics,

(ii) size of the domestic market,

(iii) high investment rate, and

(iv) high saving rate.

In 2011, out of 184 countries listed in the IMF's WEO, there were only 26 with a population of at least 10 million and growth rate of over 6 per cent. Most, if not all, are the so called emerging markets. Quite understandably, the dim view about the growth prospects of advanced economies has put the spotlight on emerging and developing economies as the new **growth drivers** of the global economy.

The underlying shift in global economic setting raises the question as to whether future changes in the world economy would unravel in a smooth manner, or be disruptive. Needless to say **India,** even while carefully responding to the immediate economic challenges emanating from domestic and global sources, will also have to craft and calibrate its policies keeping both outcomes in view.

Presently, the global situation is marked by volatility in world financial markets, uncertain growth in the advanced economies, and possible disruptions in supplies of energy apart from other *geopolitical tensions.* There is contradiction between the short-term need for growth and maintaining demand and the need for fiscal consolidation that marks the current policy environment. But even as the world economy, three years after the global financial crisis of 2008, continues to move from one uncertainty to another, there have been continuing efforts in multilateral fora such as the G-20 to bring about greater understanding and coordination in dealing with global imbalances and addressing the weaknesses that might have led to the global crisis, to arrive at measures to revive global growth.

LOCATING INDIA

Over the years, India has become a more open economy. The total share of imports and exports accounts for close to 50 per cent of GDP while that of capital inflows and outflows measures up to 54 per cent of GDP. Yet economic outcomes and their impact on growth and development arising from the interaction between the domestic and external economies are contingent on a large number of factors. Though economic outcomes are to some extent contingent on choosing policies appropriate to the conditions characterizing an economy, the relative position of an economy vis-à-vis other countries in a global setting could facilitate (or even constrain) policy choices. A few features that characterize India that may be relevant in its further engagement with the global economy as also for its future development have been discussed as below:

1. **Moved up the Ranks but the poorest of G-20:** India has emerged as the ***fourth largest*** economy (at PPP) globally with a high growth rate and has also improved its global ranking in terms of per capita income (as mentioned earlier). Yet the fact remains that its per capita income continues to be quite low (at current US $ 1527 in 2011). Addressing this is perhaps the *most visible challenge.* Though, India has a diverse set of factors, domestic as well as external, that could drive growth well into the future.

2. **Demographics:** With over 1.2 billion people, India accounts for nearly ***one-sixth*** of global population. While the rate of growth of population has consistently declined, India's population increased by nearly 180 million persons during 2001-11 (***the highest*** in the world in absolute terms). However, India is also passing through a phase when its dependency ratio will decline from an estimated 74.8 in 2001 to 55.6 in 2026 with a corresponding increase in the share of persons in working-age group. With labour being a key factor of production, a ***demographic dividend*** is a clear positive for growth. It has, however, been pointed out that much of the growth in population will occur in states that are currently poor. Therefore, for this dividend to accrue, it will be necessary to build human capital in adequate measure.

   On this count, India has shown some improvement in terms of its human development index (HDI). The UNDP's HDI, which captures the progress of a country in terms of economic indicators as well as education and health indicators increased from **0.344** in 1980 to **0.547** in 2011. India moved up from a rank of 82 in 1980 to **72** in 2011 (in a group of 100 countries for which HDI is available for these points of time). Even though India's score has improved, her HDI rank has not moved very significantly. A possible *reason* could be that some other countries may have registered faster improvement in these indices. India, therefore, needs to benchmark her achievements (on various fronts) not only in absolute terms but also in relation to other countries *(Economic Survey 2011-12, pp. 301-303)*.

3. **Exports and External Demand:** The process of globalization has been marked by a rising share of exports (as also imports) that reached 27.9 per cent for the world as a whole in 2010, with some countries showing much higher dependence of exports. The Database of the World Bank show that the so called *East Asian Miracle Economies* was that an export-led, investment-fuelled strategy propelled growth and helped them acquire manufacturing capabilities. This strategy was supported by a favourable exchange rate, cheap credit, and

relatively low wages which helped to gain competitive advantage. Global demand for goods, particularly in the advanced markets, lent support to this growth strategy. As a result, these economies moved up the value chain in manufacturing. This leads to the question of how far export can be a driver of growth for India at this point of time – we may see it in **three**[18] steps:

(i) Due to slowdown in advanced economies, the prospect of their growth fuelling demand for imports (i.e. exports from other countries), seems somewhat bleak at this juncture.

(ii) The large build-up of capacity in some countries (including China) suggests that they *might* act as barriers to new entrants for some time.

(iii) The costs of energy are rising and there are growing concerns about climate change.

In this regard, India's export (of goods and services) to GDP ratio increased from 6.2 per cent in 1990 to 21.5 per cent in 2010. Yet, India accounts for only **1.5** per cent of world exports. India's exports are also evenly balanced between merchandise and *services*. Moreover, the change in direction of exports suggests that India has been diversifying the destination of its exports away from traditional markets *(Economic Survey 2011-12, p. 349* and *Economic Survey 2012-13, p.158)*.

Therefore, there is some scope for exports to grow, particularly to the fast growing economies, many of which are in Asia and Africa and to some extent Latin America, while some of the mature markets may remain important, however with declining shares on the whole for the group. Moreover, the main advantage of a presence in the global market is of being able to benchmark to global standards and therefore worth pursuing in its own right. Additionally, the advantage of having the twin engines of domestic and export demand is that it lends the economy greater resilience to fluctuations in global demand – for which India must keep striving.

4. **Research & Development:** *'Unleashing India's Innovation' (2007)* , a World Bank Study observed that India had increasingly become a top global innovator in high-tech products and services. Yet the country is underperforming in terms of its ***innovation*** potential. India spends less than **0.9** per cent of its GDP in the area of R&D, which covers basic research, applied research, and experimental development. This fact emerges from the *OECD Fact Book 2010* that lists 41 countries with Israel ***topping*** the list on this count and most developed countries spending over **2** per cent of their GDP on R&D. While more resources into R&D would be needed, equally critical would be to harness existing institutions and organisations set up for formal R&D and also to encourage grass-roots level innovation[19].

At a point of time when there is an increasing acceptance of the fact that ***land, water,*** and ***energy*** are likely to be in short supply and environment a major concern, India is well placed to advance through the route of frugal innovation and devising of specific applications suited to the bottom of the pyramid that would not only open new market segments within India but also in other countries in the developing world. That apart, with regard to frontier areas, India is well placed to take advantage of its vast ***diaspora*** to jump-start its R&D efforts. Strategically positioning India as a hub for FDI in R&D may well be a way for it to leapfrog into the next generation of technologies and products.

5. **Energy Security:** India is characterized by a relatively *lower energy intensity* of GDP as compared to China, South Africa, and Russia but higher than that of Brazil. Advanced countries, in particular EU countries and Japan, have been witnessing a decline in the energy intensity of GDP, apart from technological improvements, due to various factors, the main one being a shift in the structure of their economies towards services *(World Bank Database)*.

   India' energy dependence on imported energy sources, appears modest at 25.7 per cent in terms of total energy usage. *(World Bank Database)*. However, this masks the fact that around ***80 per cent of the crude oil consumed is imported,*** whereas the bulk of coal is domestically produced. Even with respect to coal, the country is importing on the margin to meet domestic demand. On the other side, there is a large fraction of population that has little or no access to commercial sources of energy and depends on traditional sources.

   Rise in the ***price of oil*** in international markets has been the main source of high current account deficit. High international prices of fossil fuels also result in a higher import bill, which either gets passed on to the consumers, or results in higher subsidy thereby affecting fiscal health. That apart, the growing tensions in many oil-producing economies are a source of vulnerability for the energy security of India. In this ***one area,*** the **strategic advantage** for India would lie in diversifying its energy sources.

6. **Food Security:** To India, this implies meeting minimum energy and protein norms along with requisite micro-nutrients for all at affordable prices. With the increase in income, the demand for food in India is bound to rise further. It has also been observed that even marginal shortages in specific food items in India tend to have a disproportionately large impact on the relevant prices even in the international market. Even though India, for most food products, is not an importer in most years, dependence on global markets could imply greater vulnerability both in terms of ***prices*** and ***availability.*** The link between financialization of commodities and its impact on commodity prices and their volatility has been an issue of international concern, even though there has been no clear consensus on the cause-effect relationship[20].

7. **Fiscal Resources:** Often, a case is made for the virtues of a *minimalist state*[21] and the need to disengage from a number of activities. The actual facts speak otherwise. India's general government expenditure in relation to GDP is actually lower even in comparison to many market economies by a factor of at least half. More importantly, the ratio of general government revenues to GDP at 17.6 per cent[22] is one of the lowest in emerging economies and certainly very low in comparision to the advanced economies. Therefore, even if fiscal consolidation is needed, the priority has to be on raising resources. Recent developments in the developed economies reveal how important it is to maintain the revenue base and keep government finances in shape. The increased exposure to the external economy will make India's fiscal strength based on a large revenue base even more critical.

8. **FDI Diplomacy:** Many of the advanced economies, with deep technological strengths, are now *aging societies* and need to invest overseas and rely on factor incomes. The stage at which India is placed, the need for sustained investment has already been stressed[23]. There is an inherent complementary relationship between India's requirement for more 'real' investment and the need for some of the advanced economies, including some of the Asian industrialised economies, to invest in production facilities in friendly countries overseas in

order to diversify their supply chains.

9. **Remittances:** are an important source of financial flows and, as per World Bank estimates, remittance flows into developing countries in 2011 were to the tune of US $ 351 billion. Remittance flows into India are estimated to be of the order of US $ 58 billion. In 2010, remittances into the country accounted for *3 per cent of GDP*. Reasons[24] for such high inflows could be:
   (i) the higher oil prices that helped the Gulf countries and other oil exporters to earn higher profits/income (where a large number of Indian workers are employed – whose higher earnings made higher transfers possible to India), and
   (ii) the depreciation in rupee currency in the latter half of 2011.
10. **Systems of Economy & Polity:** The global economic crisis opened afresh the debate on the relative *role of the market and the state* as also the relative advantages of democratic versus state-led economies. The challenge of managing a mixed economy within a democratic and federal system is a complex task. However, the challenge of transiting from a state-led monolith to a more representative system may be even more daunting. In either case, for a system to thrive, economic outcomes need to be tangible. The ***critical question*** is therefore not of state versus markets but, rather, of how to maximise market outcomes (minimise market failures) and have effective governance (i.e. minimise government failure) with a democratic system as the political basis for governance.

Presently, India enjoys the unique advantage of having **multiple drivers of growth**. These are *demographic, investment (backed by domestic savings), domestic consumption,* as well as *exports* and ample *scope for FDI*, all of which are within a *pluralistic* and democratic system . This unique combination more or less assures it of strong and sustained growth. But this assurance comes with a very challenging socio-economic rider. Its vibrating pluralistic polity makes it utterly necessary to achieve/deliver positive economic outcomes in tangible way at every stage and to every section of society[25].

THE PATH TO REVIVAL

The proximate **causes** for the global financial crisis (that reached a flash point in October 2008 with the collapse of *Lehman Brothers*) have been all encompassing which may be summed-up[26] as given below:

(i) The loose monetary policies adopted by reserve currency-issuing advanced economies (particularly the US) in the run up to the crisis (at the macro level);

(ii) The mercantilist policies adopted by export-led economies leading to accumulation of large current account surpluses and forex reserves;

(iii) Weaknesses in the international monetary system (IMS), particularly the absence of *alternative reserve assets* to the dollar;

(iv) Weak regulation of financial markets and intermediaries; and

(v) Excessive financial innovation and risk taking by finance and banking intermediaries (which

led to the US ‘sub-prime crisis’) [the last four points were active at the micro level].

Attempts of the G-20

As the reasons forwarded for the global crisis varied to different issues the debates and *discussions in the G 20* (and other fora involving international organizations and financial institutions) have, therefore, been on wide-ranging issues. The question of how policies for reviving growth of individual countries impinge on the global economy and its imbalances and whether they could somehow be better coordinated has been at the centre of these discussions. These discussions are of some importance as they may, in the years to come, shape the style and substance of governance of the global economy. It is critical that the outcomes, if any, address the concerns of emerging economies *(such as India)* that are major drivers of global economic growth.

This section of the book examines a few selected issues that have been the subject of international deliberations (mainly in the G 20) and how they are relevant to India, many of them still evolving.

In 2011, the G-20 (formed in 1999 in the aftermath of the East Asian Crisis as a forum for Finance Ministers and central bank Governors) came to centrestage following the ***Leaders’ Summit*** in Washington DC in November 2008 to focus on coordinated measures to address the challenges faced in the immediate aftermath of the global financial crisis. A declaration in the G-20 Summit at Pittsburgh, USA, in 2009 *(the Pittsburgh Declaration)* formally raised the forum to the level of leaders and transformed it into the premier forum for international economic cooperation.

At its latest Summit *(sixth)* held at **Cannes,** France (3-4 November 2011), the agenda followed the priorities laid out by the French Presidency. This agenda got deliberated in 2011 in two channels:

(i) The first was the finance channel, which largely focused on the framework for strong, sustainable and balanced growth, reform of the International Monetary System (IMS), strengthening financial regulation, and other issues relating to commodity price volatility.

(ii) The second set of issues in the Sherpa’s Channel focused on development-related issues.

During the global financial crisis, collective and coordinated policy action by the G-20 through macroeconomic stimulus (fiscal and monetary) and financial-sector intervention helped avoid a catastrophic meltdown. Building on this, G-20 Leaders launched the *‘Framework for Strong, Sustainable, and Balanced Growth’* with India and Canada as the co-chairs of the Working Group in 2009. In this signature effort of the G-20, the Mutual Assessment Process (MAP) forms a medium-term exercise to ensure that collective policy actions benefit all and policies are collectively consistent with the G-20’s growth objectives.

At the **Seoul Summit** (2010) the G-20 committed to working to address key imbalances that could jeopardize growth and to enhance the MAP with indicative guidelines for key imbalances while in February 2011, the G-20 agreed to include three other important factors inducing external and internal imbalances, i.e.:

(i) public debt and fiscal deficits,

(ii) private saving and private debt, and

(iii) the external position – trade balance and net investment income flows and transfers.

The Summit was able to reach a level of **consensus** on the following points:

(i) Indicative guidelines to be used to identify systemically important countries and assess each other's economic policies;

(ii) To suggest policy remedies;

(iii) To address potentially destabilising imbalances; and

(iv) To set the stage for assessing the progress toward external sustainability.

Measured in terms of share in global GDP, in this regard, India has been identified as systemically important economy. But it is clearly a net contributor to global demand as evidenced from its current account deficit. While India's exchange rate is largely market determined, its domestic savings are largely oriented to financing domestic investment appropriate at a stage of high growth but not at the cost of curbing consumption. Even if India is not a contributor to global imbalances, its interest clearly lies in smooth resolution of these issues and towards measures that could help revive global growth.

Reforming the IMF

The current international monetary system (IMS) has no mechanism to prevent a build-up of imbalances on the external account and the burden of adjustment falls on deficit nations. In the run up to the crisis of 2008, it was felt that countries like the US could somehow sustain fiscal and current account deficits by virtue of the privilege of issuing a reserve currency. But this trend instead accentuated the so-called external imbalances, even if it was not the primary cause of the crisis that turned global.

The G 20 Working Group on Reform of the IMS (set up at the Cannes Summit) focused, among others, on capital flows and their management (CFM), the measurement of global liquidity, holding of international reserves, and future role and composition of the special drawing rights (SDR). While the *latter two issues* remain areas of continuing work, drawing on the work of the IMS group, the Cannes Summit communiqué mentions that the *'Coherent Conclusions for the Management of Capital Flows' (CCMCF)* would guide the G-20 in order to reap the benefits of financial globalisation, while preventing and managing risks that could undermine financial stability and sustainable growth at national and global levels.

Given below are a brief overview of the **Dodd-Frank Act** of the USA on its attempt towards the issue of Financial Regulation:

The financial crisis of 2007-10 led to calls for changes in the regulatory system. In June 2009, a proposal for a 'sweeping overhaul of the financial regulatory system' was introduced in the US that culminated in a legislation called the Wall Street Reform and Consumer Protection Act (*also called the Dodd-Frank Act*) in July 2010. This is a voluminous and overarching Act (1601 sections) with provisions for:

- Comprehensive regulation of financial markets (including the derivatives markets).
- Consolidation of regulatory agencies.
- Establishing of a new oversight council called the '*Financial Stability Oversight Council*' to evaluate systemic risk.
- The provisions also aim to address the 'too big to bail out' problem and bring in the

requirement of large complex financial companies submitting plans for their orderly shutdown.

- The intent is that the cost arising from liquidation of large interconnected financial companies will not fall on the taxpayers.
- The Act incorporates what has been termed the '*Volcker rule*', whereby depository banks would be prohibited from proprietary trading (similar to the prohibition of combined investment and commercial banking in the *Glass-Steagall Act*).
- The Act includes improved standards for regulation of hedge funds and credit-rating agencies, improved accounting standards, investor protection, and norms of executive compensation.
- As suggested in the title of the Act, it has provisions for consumer protection reforms and the establishment of a new consumer protection bureau and also a new Office of Minority and Women Inclusion as Federal banking and securities regulatory agencies.

This report of the US, still the most predominat player in the global economy, is being seen as the most important document towards Financial Regulation (as it has the potential to affect almost all world economies including the decisions of the G-7 and G-20, too) and thus has been a matter of great attention around the world, especially, among the EMEs. It is believed that its implementation will be followed by a wave of financial adjustments by the other economies of the world. Thus, there are chances that via this the 'good' and the 'bad' of the financial regulation will automatically diffuse into the global economy, which may 'make' or 'break' the already fragile world economy. Hence, it becomes even more significant in the changed dynamics of the global economic order.

The issue of volatility in capital flows has been of concern for several emerging markets (including India). The management of capital flows is tempered by two considerations:

(i) The *first one* is the common challenge to most developing countries and EMEs, arises from the uncertainties in global capital flows and monetary policies pursued in advanced countries. Emerging markets face sudden ***stops or reversals*** (witnessed in December of 2011) for reasons not necessarily linked to developments in their own economies but to serious difficulties faced by financial institutions in advanced economies. Quantitative easing pursued by monetary authorities in advanced countries (while understandable in the context of liquidity needed to repair adverse private and public balance sheets) is a relatively new phenomenon that has altered the composition of capital flows and made their management by recipients more difficult.

(ii) The second one specific to the India's. Notwithstanding the stability of India's balance of payments after an episode in 1991, India's current account deficit has widened over the 2011-12. The dependence on private capital inflows to finance the same has widened. It is by now known that the burden of adjustment in the current IMS falls predominantly on non-reserve-issuing current account deficit countries (like India). On that count, the Indian economy has moved towards greater openness to capital flows, though following a cautious and calibrated approach of keeping both domestic and international factors and risks in view and through judicious use of multiple instruments promoting capital flows.

In the light of the shift in external vulnerability indicators and India's currently high dependence on *imported oil,* there is need to reinforce management of the capital account (which has served India well) and also encourage more stable capital flows rather than short-term flows. Countries like India

may well need to rely on a matrix of choices comprising macroeconomic and macro prudential tools and other measures as policy instruments without being bound by a prescribed sequence. Under the circumstances, the fact that the 'Coherent Conclusions on Management of Capital Flows' (as endorsed by the G-20) are 'non-binding' needs to be taken note of.

Given below are a brief overview of the ***Vickers Commission Report*** *of the UK on its attempts towards the issue of Financial Regulation:*

The Independent Commission on Banking under Sir John Vickers submitted its report to the UK government in September 2011. The highlights of the report are:

1. One of the main reasons for bank failure during the global crisis was that they had too little equity in relation to risk- there were few restrictions on leverage.
2. The weights assigned in the 'risk-weighted' assets of the banks turned out unreliable and the erosion of equity led to concerns of solvency and contagion.
3. Though risks in banking have to rest somewhere, they should not fall on the taxpayer.
4. On 'Structural Separation' and 'Ring Fencing' – the main recommendation is that there should be a *structural separation* between retail banking and wholesale/investment banking.
5. There should be a ring fence to isolate banking activities where continuous provision of service is vital to the economy and to bank customers.
6. Domestic retail banking should be inside the ring fence.
7. Services should not be provided from within the ring fence if they are not integral to the provision of payments services to customers in the European economic area.
8. Banks with both retail and investment activities will need to keep these activities at arm's length but they could share information, infrastructure, etc.
9. Structural separation would help sustain the UK's position as a pre-eminent international financial centre, while UK banking is made more resilient.
10. Loss absorbency: the report is in broad agreement with the direction of ***Basel III*** but notes that it does not go far enough since the leverage cap is too lax for systemically mportant banks and has recommended that retail banks should have equity capital of at least 10 per cent of risk-weighted assets (CRAR).
11. The Commission has also recommended the introduction of a redirection service for personal and Small and Medium Enterprises (SME) current accounts which, among other things, would transfers accounts within seven working days.

The report has been a matter of great attention around the world, especially, among the EMEs. It is believed that the implementation of the *Vickers Commission Report* by the UK will see a wave of adjustments being followed by the other economies of the world. Thus, there are chances that via this the 'good' and the 'bad' of the financial regulation will automatically diffuse into the global economy, which may make or break the already fragile world economy!

An issue related to trends in **global liquidity** is dealing with the build-up of international reserves by some countries. It has been argued that the accumulation of reserves has *negative externalities* and also entails avoidable costs to the holding countries. The issue is when the holding of reserves can be

deemed excessive or rather *what the optimal level could be,* if any, and whether some kind of 'reserve metrics' could be adopted. While the optimal size and the utility of using reserves to intervene in currency markets may be debatable, the experience, especially in the case of economies like India, has been that reserves have helped graduate to a more open economy and smoothen investment and consumption during periods of external uncertainties caused by extraneous factors. In this context, a distinction needs to be drawn between holding of reserves by countries running a current account deficit (such as India) and reserves accumulated by countries with persistent current account surpluses in addition to large sovereign wealth funds. A related set of issues on which deliberations have been going on in the G-20:

(i) Concerns of strengthening of global financial safety nets;
(ii) Cooperation between the IMF and Regional Financial Agreements to help countries deal with exogenous shocks (and access emergency assistance); and
(iii) The adequacy of IMF's resources to play systemic role for the benefit of its whole membership.

Financial Regulation

The G-7 countries along with a few more advanced economies with large financial sectors were the most important participants in a grouping that established the ***Basel Committee*** on Banking Supervision in 1974, whose primary function was to act as a forum for coordination of supervision of the financial sector, particularly large banks, in these economies. In the wake of the major 2007-09 global financial crisis, the most severe since the 1930s, the effectiveness of financial regulation was called into question. Since then, quite significant reforms of financial regulation have taken place both within countries and internationally in terms of international regulatory standards and organisations.

Meanwhile, some of the advanced economies have started the process of *Financial Regulation Reforms*. In general, regulating financial markets and intermediaries and striking a balance between the need for maintaining financial stability and good market conduct without stifling innovation have always been a challenge. The global crisis brought home the inherent difficulty in doing that especially where financial institutions have had cross-border operations and exposures. This was because, with financial globalisation, many banks and other financial market participants had cross-border operations but were mostly subject to national regulations.

The weaknesses in financial regulation (apart from global imbalances) were perceived as a major cause of the global crisis. The Cannes Summit Communiqué 2011 (of the G-20) had reiterated the commitment that financial markets, products, and participants be regulated or subject to oversight appropriate to their circumstances in an internationally consistent and non-discriminatory way. The *declaration* spells out the initiatives taken that include the regulation of banks, over-the-counter (OTC) derivatives, compensation practices, and credit-rating agencies. The Cannes Action Plan commits to taking these initiatives further based on the work done by the Bank of International Settlements (BIS, Basel) and the Financial Stability Board (FSB)[27] on new standards for financial regulation.

The commitment to implementing the ***Basel III*** standards for banks is of particular significance to the global economy. The implementation of Basel III capital and liquidity standards starts in 2013 with

full implementation envisaged by 2019. To make sure that no financial firm is 'too big to fail' and taxpayers do not bear the costs of resolution, the FSB framework comprising new international standards for resolution, supervision, cross-border cooperation, recovery, and resolution planning from 2016 was endorsed. The FSB has also published an initial list of *Globally Systemically Important Financial Institutions (G-SIFI)* and a five-pronged work plan to develop guidelines on shadow banking. In order to prevent excessive risk taking and discourage excessive pay and bonuses, the FSB has developed principles and standards on compensation.

As the members of the Basel Committee on Banking Supervision (BCBS) and FSB, **India** is actively participating in post crisis reforms of the international regulatory and supervisory framework. The Indian financial sector is well regulated and India remains committed to adopting international standards and best practices *calibrated to its conditions*. As such, banks in India are well capitalised and it is expected that the ***Basel III*** norms are unlikely to put undue pressure on the banking system on aggregate. India had even earlier implemented some countercyclical policies like provisioning norms and differential risk weights (for example for the real estate sector, capital markets, and personal loans) to control build-up of risks even before these were internationally proposed.

But, there are some caveats on the implementation of the emerging regulatory standards across countries. Given that the financial sector in many countries has its specificities, and there is likely to be resistance to change from several market participants, it is yet to be seen whether all these reforms will get carried out in all the countries and not diluted. While all G-20 countries have committed to implement Basel III, major jurisdictions have separately come out with their own regulatory standards: the *Dodd Frank Act* in the United States and the *Vickers Commission* recommendations in the United Kingdom with the EU too having its own rules. A concern that arises is that if same standards are not implemented in all jurisdictions simultaneously, there could be scope for regulatory arbitrage that could result in financial activity migrating to less-regulated jurisdictions, as well as into shadow banking. In the short run, there are also concerns that tightening of regulatory standards, even while recovery in advanced economies from the past and continuing crisis is not over, may make banks risk averse and adversely impact financial intermediation and lending to the *real sector* (i.e. the *real estate* sector).

Development Issues

The *G-20 Development Agenda* comprised a Multi-Year Action Plan based on **nine pillars** announced at the Seoul Summit, of which the French Presidency focused on *infrastructure* and *food security* for the Cannes Summit. The other pillars are *human resource development; trade; private investment and job creation; financial inclusion; growth with resilience; knowledge sharing;* and *domestic resource mobilisation*. Many of these issues have been in the subject domain of a number of developmental agencies.

While India has assigned high priority to issues relating to development appropriate to country-specific conditions, an issue deserving priority is of recycling global savings for infrastructure investment. Enhancing infrastructure investment in emerging economies and developing countries would have positive implications for rebalancing global demand as also for reviving and sustaining growth. At the same time, high savings would find productive use.

Role of Finance in Development

While on one side, global forums like the G-20 and international regulatory bodies continued to deliberate on issues relating to financial regulation, the year 2011 was also marked by rising concern across the world that 'finance' had somehow got de-linked from serving the interests of the real economy and that various regulatory and compensation practices are out of sync with the needs of the rest of the economy.

The issue of compensation in the financial sector has been a *major area of debate* not just in the G-20 but also in the media in general. Similarly, the issue of financialisation of commodities and speculation leading to volatility in commodity prices and the idea of implementing a tax on financial transactions have been contentious issues on which no clear consensus has emerged. Of late, an area of concern even among serious academic researchers has been whether the financial sector has become just too big in some advanced economies and whether its value addition is really genuine and correctly measured.

Whether these views and perceptions are correct or misplaced, regardless of this fact, these debates and the ongoing work need to be taken note of in policy. Fortunately, the **Indian** financial sector and its banks have thus far been well regulated and to ensure that it serves the real sector has been an abiding policy concern. Nevertheless, given the criticality of the role of finance in development, the Indian regulatory system would also need to maintain and strengthen its vigil to ensure that growth in the financial sector and the intermediation process go towards furthering economic development and financial inclusion.

G-20 Agenda in 2012

Mexico has taken over Presidency of the G-20 after the *Cannes Summit* and released a strategic vision of the G- 20 agenda spelling out the following priorities:

I. Economic stabilization and structural reforms as foundation of growth and employment.

II. Strengthening the financial system and fostering financial inclusion to promote growth.

III. Improving the international financial architecture in an interconnected world.

IV. Enhancing food security and addressing commodity price volatility.

V. Promoting sustainable development and green growth in the fight against climate change.

PROSPECTS FOR INDIA

India has entered a 'critical decade'[28]. It has emerged as a large and systemically important economy on the global stage. It enjoys the unique advantage of having many economic indicators in its favour, particularly a large domestic market, robust investment-to-GDP ratio, and demographic advantage. However, all of these will need to be leveraged to get the full advantage out of them. Undoubtedly, this requires India to address its internal challenges, which include the long-standing problem of poverty and the development of its social and physical infrastructure.

India, given its size and its profile in the global economy, will inevitably need to play an active role at global level, not just in debates about how to resolve the continuing crisis and prevent the recurrence of similar crises in the future, but in influencing the rules for the global economy on overarching macroeconomic issues such as trade, capital flows, financial regulation, climate change, and governance of global financial institutions.

On the front of engaging the global economy, at this juncture, India may be advised to take a *passive stance* in the current global debate and just wait for the period of crisis to fade out. This looks the easy choice, too. But this option is no longer realistically feasible due to two reasons:

(i) India is already too much a part of the global economy and polity; and

(ii) developments in the world will affect India deeply and what India does will affect the world.

Therefore, there seems a need for India to engage with the world in terms of action and ideas. A majority of experts all over the world, including the policy-makers in India and its economic think-tank, seem to agree on this stance being taken by India while engaging the new global economic order. To conclude briefly, we may say that India is destined to affect/write the emerging global economic order – naturally, according to its future economic determinants and the world community at large.

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1. ***Economic Survey 2011-12,*** op. cit., p. 337.
2. This is the way the ***Ministry of Finance*** (GoI) looks upon the area which has been amply visible in views of the various Central Ministries, especially the ***Ministry of Commerce,*** the ***RBI*** and the annual publication the ***Economic Survey 2011-12.***
3. Based on the data released by the ***World Economic Outlook (OEO),*** an annual publication of the IMF, Jan. 2012 and the ***Principal Global Indicators,*** an annual publication of the Organisation for Economic Cooperation and Development (OECD), Paris, Jan. 2012.
4. We see it happening, especially, when the US Federal Reserve goes for revisions in its monetary policy stance – the central banks of almost whole world start re-adusting their own monetary policies (in this way the domestic concerns of these economies have suffered throught 2010 and 2011).
5. ***Employment Outlook-2011,*** an annual publication of the OECD, Paris, Jan. 2012.
6. Analyses regarding the ensuing Eurozone Crisis is based on various news reportings and news analyses which appeared around the world including India – the present one is basically modelled on the views and stances of the ***Ministry of Finance, Ministry of Commerce, Reserve Bank of India,*** and the ***Economic Survey 2011-12,*** GoI, N. Delhi, ranging between May 2010 and May 2012.
7. ***Economic Survey 2011-12,*** op. cit., based on the *World Economic Outlook* of the IMF and the reports of the *International Finance Corporation* (a World Bank group of financial institution).
8. Based on the decadal data of the WEO, quoted by the Economic Survey 2011-12, op. cit.
9. ***United Nations Conference on Trade and Development (UNCTAD) Report-2011,*** as quoted in the Economic Survey 2011-12, op. cit.
10. ***World Trade Organisation,*** as quoted in the Economic Survey 2011-12, op. cit.
11. Computed from the ***World Bank*** database as quoted in the Economic Survey 2011-12, op. cit.
12. Based on the data released by the ***United Nations Population Division*** in Jan. 2012 as quoted by the *Economic Survey 2011-12,* op. cit.
13. ***WEO,*** IMF database, September 2011 and ***Fiscal Monitor Update,*** IMF, Jan. 24 2012 – as quoted in the Economic Survey 2011-12, op. cit.
14. As on Dec. 31, 2012, ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, see pp. 137-139 for details.
15. ***A. M. Spence (2011),*** 'The Impact of Globalization on Income and Employment: The Downside of Integrating Markets' *Foreign Affairs,* Vol. 90., p. 29.
16. ***R. Zagha,*** 'Global Imbalance: Policies, Structure and Finance', in S. Kochhar (ed.) *Policymaking for Indian Planning, 2012,*

Academic Foundation, N. Delhi.

17. ***Economic Survey 2011-12,*** op. cit., p. 346.

18. As discussed by the ***Economic Survey 2011-12,*** op. cit., p. 349.

19. These facts and the concerns of the GoI was at first enumerated by the India's PM in one of his crucial interactions with the Confederation Indian Industry (CII) mid-Feb. 2012.

20. The GoI has also been not adamant on the stand as whether the Commodity Market Exchages support the market, producers and the consumers by a rational price search or are the cause of price rises as the participants start speculating an imminent price rise in coming times if there is a projection of lower productions by the government! We have seen the GoI banning trade in certain commodities at one time and allowing it at other!

21. A *minimalist state* (also called *'night watchman state'*) is variously defined – in the strictest sense, it is a form of government in political philosophy where the state's only legitimate function is the protection of individuals from aggression, theft, breach of contract, and fraud, and the only legitimate governmental institutions are the military, police, and courts, fire departments, prisons, the executive, and legislatures. The role of state regarding 'social sector' (such as education, health, etc. which expanded after the Keynesian denial of Adma Smith caught fancy in the post-Great Depression era) is not considered suitable for such states.

22. ***Economic Survey 2011-12,*** op. cit., p. 350, Table 14.8

23. ***Economic Survey 2011-12,*** op. cit., p. 104-129.

24. ***Economic Survey 2011-12,*** op. cit., p. 134.

25. As it is visibly clear from the ensuing movements led by the ***Civil Society*** vibrating basically on the rational base provided by the Right to Information – has been duely highlighted by the ***Economic Survey 2011-12,*** too in the Chapter- 2, op. cit. p.30.

26. Discussed at different fora by the central banks, trade groupings of the world and the experts since 2008 – also concisely highlighted by the ***Economic Survey 2011-12,*** op. cit., pp. 337-57.

27. '*Financial Stability Board (FSB)* came up in 2009 originating from the erstwhile existing global body, the Financial Stability Forum (FSF). The FSF was established by the G-7 finance ministers and central bank governors in 1999 to promote international financial stability through enhanced information exchange and international cooperation in financial market supervision and surveillance. It decided at its Plenary Session in London on 11-12 March 2009 to broaden its membership and invite as new members the G20 countries that were not initially in the FSF. These included Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey. In order to mark a change and convey that the FSF would play a more prominent role in this direction in the future, the FSF was relaunched as the Financial Stability Board (FSB) on 2 April 2009, with an expanded membership and broadened mandate to promote financial stability. The current FSB comprises national financial authorities (central banks, supervisory authorities, and finance ministries) from the G20 countries, as well as international financial institutions, international regulatory and supervisory groupings, committees of central bank experts, and the European Central Bank', as described in the ***Economic Survey 2010-11,*** MoF, GoI, N. Delhi, p. 125.

28. ***Economic Survey 2011-12*** seems concluding its views on the 'India Story' by using the phrase 'critical decade' from the very title of a recently published book by ***Rajeev Malhotra*** but, without refering the author's name. The book is – Rajeev Malhotra (Edited), ***A Critical Decade: Policies for India's Development,*** Oxford University Press, N. Delhi, India, released on **1st March 2012.** The editor, Rajeev Malhotra is, the erstwhlie *Economic Adviser,* Office of the Finance Minister, GoI and has been the principal author of the **first** *National Human Development Report 2001* (published jointly by the Planning Commission, GoI and the Oxford University Press, 2002). Contributors to this edited volume are senior-level economists/advisers in the GoI. The book has 'Foreword' by ***Kaushik Basu, the Chief Economic Adviser, Ministry of Finance, who led the team which compiles the annual publication of the Ministry, the Economic Survey.***

11

INDIAN FINANCIAL MARKET

*There is now ample empirical research to corroborate Schumpeter's conjecture that financial development facilitates real economic growth. The depth of the financial markets and availability of diverse products should therefore not be treated as mere adornment but as critical ingredients of inclusive growth.**

- Introduction
- Indian Money Market
- Indian Capital Market
- Indian Money Market
- Need for Money Market
- Money Market in India
- Discount and Finance House of India (DFHI)
- Monetary Policy Tools
- Indian Capital Market
- Project Financing
- Financial Institutions
- Mutual Fund (MF)

* As *Economic Survey 2011-12* (MoF, GoI, N Delhi, p. 40) refers to the Australian economist Joseph A Schumpeter (1883-1950) to emphasise the importnance of the Financial Market in an economy.

INTRODUCTION

The market of an economy where funds are transacted between the fund-surplus and fund-scarce individuals and groups is known as the financial market (definition) [1]**.** The basis of transaction is either *interest* or *dividend*. This market might have its organised (institutionalised) as well as non-organised (unregulated/non-institutionalised) segments in an economy and may serve the purpose of supply of funds for the *short-term* or the *long-term* periods.

Financial markets in every economy are having two separate segments today, one catering to the requirements of the *short-term funds* and the other to the requirements of the *long-term funds*[2]. The short-term financial market is known as the ***money market*** while the long-term financial market is known as the ***capital market.*** The money market fulfills the requirements of funds for the period upto 364 days (*i.e. short term*) while the capital market does the same for the period above 364 days (*i.e., long term*)[3]. The structure of the Indian Financial Market today may be seen in the following way:

A. Indian Money Market

B. Indian Capital Market

A. INDIAN MONEY MARKET

India money market is among the emerging money markets of the world today but yet undeveloped in comparison to the markets of the developed economies[4]. The organised and unorganised segments of the market are co-existing today side by side, though the unorganised segment is not totally unregulated in India. The structure and the components of the Indian money market are as given.[5]

1. Organised Indian Money Market

Present since independence, its real development took place after the year 1985. Today there are eight instruments or components of the Indian money market especially designed to fulfill the short-term fund requirements of the different categories of the individuals, institutions or the firms and companies:

(i) Treasury Bills

(ii) Call Money Market

(iii) Certificate of Deposit

(iv) Commercial Bills

(v) Commercial Papers

(vi) Mutual Funds

(vii) Repo and Reverse Repo Markets.

(viii) Cash Management Bill

2. Unorganised Indian Money Market

This is comparatively an older money market of India still perpetuating even after the expansion of its organised form. The unorganised money market is called 'unorganised' as there is no systematic regulatory framework for them. Still, there is a nominal legal provision which gives them a bit of official form. As for example, the RBI has fixed the highest rate of interest charged by the indigenous bankers today at ***33.33 per cent*** per annum which they follow while lending at least on paper with revenue stamps affixed (though, everybody knows the real interest charges which are at times, higher and highly exploitative)[6]. The lender uses the paper in courts in the case of defaulter. As the unorganised segment of the money market has access to the areas where the organised segment has still not reached, its function is considered important for the proper functioning of the economy in India. They are highly active at the major ports of India, the stone cutting and polishing centres in Gujarat today. The major components of the unorganised money market in India are as given below:

(i) The ***hundis*** which are there in indigenous bill markets.

(ii) The ***Shroffs*** in Gujarat and ***Kayas Marwaris*** and ***Pathans*** in India.

(iii) The indigenous bankers specially in Mumbai and Ahmedabad.

(iv) The small/big ***businessmen*** and ***money - lenders*** (specially in rural areas and small towns).

As money market facilitates the availability of the working capital for the business and commercial houses it is also known as the ***working capital market.***

Money market in India is primarily regulated by the RBI except the Mutual Funds which have dual regulators—the RBI and the SEBI. Money market in India still has enough scope for expansion and a lesson might be taken from the other developed economies.

B. INDIAN CAPITAL MARKET

Indian capital market which facilitates the long-term requirements of funds in the economy has seen accelerated expansion in the past six decades[7]. The structure and components of the market can be understood in the following way:

1. Financial Institutions

This segment of the capital market was developed by the Government of India to fulfill the capital requirements of the upcoming industries in the country better known as the business of ***'project financing'***[8]. In the due process of time we see emergence of four categories of Financial Institutions (FIs) in India:

(i) All India Financial Institutions (AIFIs) such as the IFCI, ICICI, IDBI, SIDBI and IIBI, etc. Presently, there are only four financial institutions which are regulated by the RBI as the AIFIs – EXIM Bank, NABARD, National Housing Bank (NHB), and the Small Industries Development Bank of India (SIDBI).[9]

(ii) Specialised Financial Institutions (SFIs) such as the RCTC and TFCI.

(iii) Investment Institutions (IIs) such as the LIC, GIC and the UTI.

(iv) State Level Financial Institutions (SLFIs) with its two variants, the SFCs and the SIDCs.

2. Banking Industry

With the passage of time, there developed a number of government and privately owned banks in the country, and became the mainstay of the capital market by the 1980s.

3. Security Market

After the government's attempts to formally organise the security and stock market of India, the segment has seen accelerated expansion. Today, it is counted among the most vibrant share markets of the world and has challenged the monopoly of the banks in the capital market of the country[9].

Financial Regulators

At present Indian financial market has a number of regulators, precisely ***eleven***—RBI, SEBI, FMC, NABARD, IRDA, SIDBI, NHB, SFCs, LDBI, CLB and Registrar of Cooperative Societies.

The Narasimhan Committee on Financial System (1991) has made a strong case for a single requlator for banks, financial institutions and the non-banking financial institutions in India.

Meanwhile, the **Justice B N Srikrishna** headed Financial Sector Legislative Reforms Commission (FSLRC) handed over its report *end-March 2013* – it was set up March 2011 for examining the regulatory structure and the laws governing the financial sector. The 10-member committee had a broad *mandate* covering all financial services as well as everything currently overseen by any financial regulator. Broadly, the commission has recommended what can be called a changeover from an areabased division of regulators to a task-based division. Major highlights of the recommendations are as follows:

i. Today, each agency like the Sebi or the IRDA or the FMC looks after one type of financial service or one area – this would be replaced by a horizontal structure whereby the basic regulatory and monitoring functions of all areas would be done by a Unified Financial Agency (UFA).
ii. All consumer complaints, regardless of the area will be handled by a Financial Redressal Agency (FRA).
iii. There will be a single tribunal, the Financial Sector Appellate Tribunal (FSAT) which will hear appeals regarding the entire sector.
iv. There are also three other agencies in the recommendations, along with the Reserve Bank of India which will continue to oversee banking.

The horizontal structure will serve the interests of the consumers of financial services (of individuals and businesses, both) much better. For one, it should *eliminate regulatory arbitrage* – the recent IRDA vs SEBI spat on ULIPs happened because the two agencies' views on the characteristics of investment products were very different. Another advantage of the horizontal structure would be that consumer complaints about a sector would get separated from the regulator. This is important because a certain class of consumer complaints have mistakes or oversights by the regulator at their root. Recognising this root cause means admitting to its own flaw, something that is hard for any organisation.

A. INDIAN MONEY MARKET

Money Market is the short-term financial market of an economy. In this market, basically, money is traded between individuals or groups (i.e., financial institutions, banks, government, companies, etc.) who are either *cash-surplus* or *cash-scarce*. The trading is done on a rate known as *discount rate* which is determined by the market and guided by the availability of and demand for the cash in the day-to-day trading[10]. The 'repo rate' of the time (announced by the RBI) works as the guiding rate for the current 'discount rate'. Borrowings in this market may or may not be supported by collaterals. In money markets the *financial assets* which have quick conversion quality into money and carry minimal transaction cost are also traded[11]. Money market may be *defined* as *a market where short-term lending and borrowing takes place between the cash-surplus and cash-scarce sides.*

The market operates in both 'organised' and 'unorganised' ways in India. Starting from the 'person-to-person' mode and converting into 'telephonic transaction', it has now gone *online* in the age of internet and information technology. The transactions might take place through the intermediaries (known as brokers) or directly between the trading sides.

The short-term financial market of an economy is known as the money market. In the money market, basically money is traded between individuals or groups (i.e., financial institutions, banks, government, companies, etc.) who have either cash-surplus or cash-scarce. The trading is done on a rate also known as ***discount rate*** which is determined by the market and guided by the availability and demand for the cash in the day-to-day trading[10]. No collateral security is required to borrow from the money market. In many markets the financial assets which have quick conversion quality into money[11] and carry minimal transaction cost are also traded. Money market may be **defined** as ***a market where short-term (upto 364 days) lending and borrowing takes place between the cash-surplus and cash-scarce sides.***

There are no organised places for the transactions of the money market. It basically started with a telephonic transaction which has now gone ***online*** in the age of internet and information technology. The transactions might take place through the intermediaries (known as brokers) or directly between the trading sides.

NEED FOR MONEY MARKET

For growth to take place, investments are required in the form of productive assets. Such investments are long-term in nature. Funds for long-term purposes are raised either through borrowings from the banks, or the financial institutions, or through the security market by issuing shares or debentures. Such funds are supplied by the long-term financial market, i.e. the capital market and the firms or the productive assets are set up in an economy. But only the setting up of firms does not guarantee production as these firms keep facing fund mismatches in the process of continued production. There is another required segment of financial market which could supply timely funds to these firms so that they could continue their production process. Such funds are required usually for a short period (days, fortnights, few months) of time and thus are considered as their working capital requirements. The

segment of financial market which caters to the short-term requirements of such funds for the eneterprises is known as the ***money market*** or the ***working capital market*** of the economy. The short-term period is defined as upto 364 days.

The crucial role money market plays in an economy is proved by the fact that if only a few lakhs or crores of rupees of working capital is not met in time, it can push a firm or business enterprise to go for lock-out set up with thousands of crores of capital. If lock-out happens, the firm might default in its payments losing its age-old credit-worthiness! This is why it is essential for every economy to organise a strong and vibrant money market which has wider geographic presence (the reason why it is today internet-based).

Which of the components of the financial market is more important for an economy, money market or capital market? This question is not logical, as both are complementary to each other. If the financial market needs to serve its real purpose for the economy, both the segments need strengthening and vibrancy.

MONEY MARKET IN INDIA

The organised form of money market in India is just about two decades old. However, its presence has been there but restricted to the use of the Government only[12]. It was the ***Chakravarthy Committee*** (1985) which for the first time underlined the need of an organised money market in the country[13] and the ***Vahul Committee*** (1987) laid the blue print for its development[14].

Money market in India is not an integrated unit and today it has two segments:

1. Unorganised Money Market
2. Organised Money Market

1. Unorganised Money Market

Before the Government started the organised development of the money market in India, its unorganised form had its presence since the ancient times—its remnant is still present in the country in its same form. Their activities are not regulated like the organised money market. The unorganised money market in India may be divided into three differing categories:

(i) Unregulated Non-Bank Financial Intermediaries

Unregulated Non-Banking Financial Intermediaries are functioning in the form of ***chit funds, Nidhis*** (operate in South India which lend to only their members) and loan companies. They charge very high interest rates (i.e. 36 to 48 per cent per annum) thus are exploitative in nature and have selective reach in the economy.

(ii) Indigenous Bankers

Indigenous Bankers receive deposits and lend money in individual or private firms' capacity. There are basically four such bankers in the country functioning individually as non-homogenous groups:

(a) ***Gujarati Shroffs*** They operate in Mumbai, Kolkata as well as industrial, trading and port cities in the region.

(b) ***Multani or Shikarpuri Shroffs*** They operate in Mumbai, Kolkata, Assam tea gardens and North Eastern India.

(c) ***Marwari kayas*** They operate mainly in Gujarat with a little bit of presence in Mumbai and Kolkata.

(d) ***Chettiars*** They are active in Chennai and at the ports of southern India.

(iii) Money Lenders

They constitute the most localised form of money market in India and operate in the most exploitative way. They have their two forms:

(a) The professional money lenders who lend their own money as a profession to earn interest income.

(b) The non-professional money lenders who might be businessmen and lend their money to earn interest income as a subsidiary business.

Today, India has seven organised instruments of the money market which are used by the prescribed firms in the country but the unorganised money market also operates side by side. The main reason behind this reality could be summed up[15] in the following points:

(i) Indian money market is still under-developed.

(ii) Penetration and presence of the instruments of the organised money market is still half-hearted.

(iii) There are many needful customers in the money market who are not taken care of by the organised money market.

(iv) Entry to the organised money market for its customer is still restrictive in nature—not allowing small businessmen.

(v) This is why the vacuum is filled up by the unorganised money market.

2. Organised Money Market

Since the Government started developing the organised money market in India (mid-1980s), we have seen the arrival of a total number of ***seven instruments*** designed to be used by different categories of business and industrial firms. A brief description of these instruments follows:

(i) Treasury Bills (TBs)

This instrument of the money market though present since indepence got organised in 1986. They are used by the Central Government to fulfill its short-term liquidity requirement upto the period of 364 days. There developed ***five types*** of the TBs in due course of time:

(a) 14-day (Intermediate TBs)

(b) 14-day (Auctionable TBs)

(c) 91-day TBs
(d) 182-day TBs
(e) 364-day TBs

Out of the above five variants of the TBs, at present only the ***91-day TBs***, ***182-day TBs*** and the ***364-day TBs*** are issued by the Government—other three variants were discontinued in 2001.[16]

The TBs other than providing short-term cushion to the Government, also function as short-term investment avenues for the banks and financial institutions, besides functioning as requirements of the CRR and SLR of the banking institutions.

(ii) Certificate of Deposit (CD)

Organised in 1989, the CDs are used by the ***banks*** and issued to the depositors for a specified period less than one year—they are negotiable and tradable in the money market. Since 1993 the RBI allowed the financial institutions to operate in it - IFCI, IDBI, ICICI, IRBI (IIBI since 1997) and the Exim Bank—they could issue CDs for the maturity periods above one year and upto three years.

(iii) Commercial Paper (CP)

Organised in 1990 it is used by the ***corporate houses*** of India (which should be a listed company with a working capital of not less than 5 crore). The CP issuing companies need to obtain a specified credit rating from an agency approved by the RBI (such as CRISIL, ICRA).

(iv) Commercial Bill (CB)

Organised in 1990, the CBs are issued by the All India Financial Institutions (AIFIs), Non-Banking Finance Companies (NBFCs), Scheduled Commercial Banks, Merchant Banks, Co-operative banks and the Mutual Funds. It replaced the old Bill Market available since 1952 in the country.

(v) Call Money Market (CMM)

This is basically an ***inter-bank*** money market where funds are borrowed and lent for one day. Also known as ***over-night borrowing*** (called as **money at call**) and for a period upto 14 days (called **short notice**). No collateral is required to borrow from this market. Funds are usually raised from this market upto three days—the higher the interest, the longer the period for which the funds have been borrowed.

The scheduled commercial banks, co-operative banks operate in this market as both the borrowers and lenders while LIC, GIC, UTI, IDBI and NABARD are allowed to operate as only lenders in this market. The interest rate in this market depends upon the demand and supply of the funds on a particular day which is market determined.

(vi) Money Market Mutual Fund (MF)

Popular as Mutual Funds (MFs) this money market instrument was intorduced/organised in 1992 to provide short-term investment opportunity to the ***individuals.***

The initial guidelines for the MF have been liberalised many times. Since March 2000, the MFs have been brought under the preview of the SEBI besides the RBI. At present, a whole lot of financial institutions and firms are allowed to set up the MF—commercial banks, public and private financial institutions and private sector companies. At present 35 MFs are operating in the country—managing a corpus of 3,41,378 crore.

(vii) Repos and Reverse Repos

In the era of economic reforms the development of ***money market*** and the ***reverse repo money market*** are considered the most dynamic and the most favored instruments of the Indian money market by the experts. 'Repo' is basically short form or the acronym of the ***rate of repurchase.*** The RBI in a span of four years, introduced this instrument of the money market—***repos*** in December 1992 and ***reverse repos*** in November 1996.

Repos allow the banks and the financial institutions to borrow money from the RBI for the short-term (by selling Government Securities to the RBI). In ***reverse repos,*** the banks and financial institutions purchase Government securities from the RBI (basically here the RBI is borrowing from the banks and the financial institutions). All the Government securities are dated and the interest for the repo or reverse repo transactions are announced by the RBI from time to time.

The provision of repos and the reverse repos have been able to serve the liquidity evenness in the economy as the banks are able to get the required amount of funds out of it, and they can park surplus idle funds through it. These instruments have emerged as important tools in the management of the monetary and credit policy in the recent years.[17]

(viii) Cash Management Bill (CMB)

The Government of India, in consultation with the Reserve Bank of India, decided to issue a new short-term instrument, known as Cash Management Bills, since August 2009 to meet the temporary cash flow mismatches of the Government. The Cash Management Bills are *non-standard* and *discounted instruments* issued for maturities less than 91 days.

The Cash Management Bills have the *generic character of Treasury Bills* (issued at discount to the face value); are tradable and qualify for *ready forward facility;* investment in it is considered as an eligible investment in Government Securities by banks for SLR.

It should be noted here that the existing Treasury Bills serve the same purpose but as they were put under the WMAs (Ways & Means Advances) provisions by the GoI in 1997 they did not remain a fluid route to government in meeting its short-term requirements of funds at its will (see 'Fiscal Consolidation in India' sub-topic in the Chapter Public Finance for details). The CBM does not come under the similar WMAs provisions.

DISCOUNT AND FINANCE HOUSE OF INDIA (DFHI)

The Discount and Finance House of India Limited[18] (DFHI) was set up in April 1988 by the RBI

jointly with the public sector banks and financial investment institutions (i.e. LIC, GIC and UTI). Its establishment was an outcome of the long-drawn need of the following two types:

(i) to bring an equilibirium of liquidity in the Indian banking system and

(ii) to impart liquidity to the instruments of the money market prevalent in the economy.

The DFHI functions on ***commercial basis.*** Today, the house deals in all the instruments of the Indian money market without any ceiling, and plays the role of the ultimate body in providing stability to the liquidity in the money market as well as the banking system.

MONETARY POLICY TOOLS

Monetary policy deals with all those instruments/means by which short-term money/capital is raised in the economy, i.e., the money which is raised for a 1 to 364 days. The policy and the instruments are regulated by the Indian central bank, the RBI. The monetary policy tools used presently and their operating procedure are as given below[19]:

1. Call Money Market

The call money market is an important segment of the money market where uncollateralized borrowing and lending of funds take place on ***overnight basis***. Participants in the call money market in India currently include scheduled commercial banks (SCBs)- excluding regional rural banks), cooperative banks (other than land development banks), and primary dealers, both as *borrowers* and *lenders* (RBI's Master Circular dated 1 July 2011). Prudential limits, in respect of both outstanding borrowing and lending transactions in the call money market for each of these entities, are specified by the RBI.

2. Open Market Operations (OMOs)

OMOs are conducted by the RBI via the sale/purchase of government securities (G-Sec) to/from the market with the ***primary aim*** of modulating rupee liquidity conditions in the market. OMOs are an effective quantitative policy tool in the armoury of the RBI, but are constrained by the stock of government securities available with it at a point in time.

3. Liquidity Adjustment Facility (LAF)

The LAF is the key element in the monetary policy operating framework of the RBI (introduced in June 2000). On daily basis, the RBI stands ready to lend to or borrow money from the banking system, as per the latter's requirement, at fixed interest rates. The ***primary aim*** of such an operation is to assist banks to adjust to their day-to-day mismatches in liquidity, via *repo* and *reverse repo* operations.

Under the repo or repurchase option, banks borrow money from the RBI via the sale of securities with an agreement to purchase the securities back at a fixed rate at a future date. The rate charged by the RBI to aid this process of liquidity injection is termed as the repo rate. Under the reverse repo

operation, the RBI borrows money from the banks, draining liquidity out from the system. The rate at which the RBI borrows money is the reverse repo rate. The interest rate on the LAF is fixed by the RBI from time to time (with crucial changes introduced recently in the operating procedure of Monetary Policy detailed in the next paragraph). LAF operations help the RBI effectively transmit ***interest rate signals*** to the market.

Recent Changes in Monetary Policy

Effective 3 May 2011, based on the recommendations of the *Working Group on Operating Procedure of Monetary Policy,* the operating framework of monetary policy has been refined with the following changes:

(i) The repo rate has been made the only independently varying policy rate.

(ii) A new marginal standing facility (MSF) has been instituted, under which SCBs have been allowed to borrow overnight at their discretion, up to 1 per cent of their respective NDTL, at 100 bps above the repo rate. The revised MSF reverse repo corridor has been defined with a fixed width of 200 bps with the repo rate placed in the middle of the corridor.

(iii) The reverse repo rate has been placed 100 bps below and the MSF rate 100 bps above the repo rate.

It is expected that the fixed interest rate corridor, set by the MSF rate and reverse repo rate, by reducing uncertainty and avoiding difficulties in communication associated with a variable corridor, will help in keeping the overnight average call money rate close to the repo rate.

INDIAN CAPITAL MARKET

Money Market is the short-term financial market of an economy. In this market, basically, money is traded between individuals or groups (i.e., financial institutions, banks, government, companies, etc.) who are either *cash-surplus* or *cash-scarce*. The trading is done on a rate known as *discount rate* which is determined by the market and guided by the availability of and demand for the cash in the day-to-day trading[10]. The 'repo rate' of the time (announced by the RBI) works as the guiding rate for the current 'discount rate'. Borrowings in this market may or may not be supported by collaterals. In money markets, the *financial assets* which have quick conversion quality into money and carry minimal transaction cost are also traded[11]. Money market may be *defined* as *a market where short-term lending and borrowing takes place between the cash-surplus and cash-scarce sides.*

The market operates in both 'organised' and 'unorganised' ways in India. Starting from the 'person-to-person' mode converting into 'telephonic transaction' it has now gone *online* in the age of internet and information technology. The transactions might take place through the intermediaries (known as brokers) or directly between the trading sides.

PROJECT FINANCING

After independence, India went for intensive industrialisation to achieve rapid growth and development. To this end, the main responsibility was given to the Public Sector Undertakings (PSUs). For industrialisation we require capital, technology and labour, all being typically difficult to manage for India. For capital requirement, the Government decided to depend upon internal and external sources to procure it. For rupee requirement of capital, the government decided to set up the financial institutions (FIs). To a limited extent FIs also served the foreign currency requirement (as in the case of the ICICI). Though India was having banks but due to low saving rate and lower deposits with them, the upcoming industries could not be financed. The main borrowers for industrial development were the PSUs. To support the capital requirement of the 'projects' of the public sector industries, the government came up with different types of financial institutions. The industrial financing supported by these financial institutions was known as project financing in India.

FINANCIAL INSTITUTIONS

The requirement of project financing made India to go for a number of FIs from time to time which are generally classified into four categories[20] :

1. All India Financial Institutions (AIFIs)

IFCI (1948); ICICI (1955); IDBI (1964); SIDBI (1990) & IIBI (1997). All of them were public sector FIs except the ICICI which was a joint sector venture with initial capital coming from the RBI, some foreign banks and FIs. The public sector FIs were funded by the Government of India.

By 1980s, all Indian banks had wider capital base and by early 1990s when the stock market became popular, it became easier for the corporate world to tap cheaper capital from these segments of capital market[21]. The era of economic reforms had given the same option to the PSUs to tap new capital. As the AIFIs had more or less fixed rate of interest as compared to the banks which could mobilise cheaper deposits to lend cheaper—the AIFIs seemed to become irrelevant. The AIFIs witnessed a sharp decline in recent years.[22] At this junction the Government decided to convert them into **Development Banks**[23] (suggested by the Narasimhan Committee-I) to be known as the All India Development Banks (AIDBs).

In 2000, the government allowed the ICICI to go for a **reverse merger** (when an elder enterprise is merged with a younger one) with the ICICI Bank – the first AIDB emerged with no obligation of project financing.

In a similar move, the IDBI was reverse merged with the IDBI Bank in 2002 and the second AIDB emerged. But it has still the obligation of carrying its project financing duties.

In 2004 (by the NDA Government), a proposal was discussed to allow a merger of the FIs merging the IFCI and IIBI with the nationalised bank PNB and thus would have emerged India's first **Universal Bank**[24]. But the proposal is now almost sidelined with the political mandate changing at the centre.

Meanwhile, the GoI considers only **four** institutions as the AIFIs ***regulated*** by the RBI, viz. the EXIM Bank, NABARD, NHB and SIDBI. Rest of them have either become 'development/universal banks'

or are under their process of 'restructuring' in the direct preview of the Ministry of Finance. In 2001-02, the GoI had tried to merge the IFCI and IIBI into the nationalised bank PNB to mark the beginning of a very big bank of international stature (in pursuant to the suggestions of the Narasimhan Committee-II following its 3-Tier Banking Structure of India). But the move could not materialise as the PNB probably backed out of the proposal (due to heavy due losses of these AIFIs)[25].

2. Specialised Financial Institutions (SFIs)[26]

Two new FIs were set up by the central government in the late 1980s to finance the risk and innovation in the area of industrial expansion. They were India's first trial in the area of **venture capital**:-

(i) Risk Capital and Financial Corporation Ltd (RCTC) set up in 1988

(ii) Tourism Finance Corporation of India Ltd (TFCI) set up in 1989.

(iii) IFCI Venture Capital Funds Ltd. (IFCI Venture) was promoted as a Risk Capital Foundation (RCF) in 1975 by the IFCI Ltd., a society to provide financial assistance to first generation professionals and technocrat entrepreneurs for setting up own ventures through soft loans, under the Risk Capital Scheme.

In 1988, RCF was converted into a company, Risk Capital and Technology Finance Corporation Ltd. (RCTC), when it also introduced the Technology Finance and Development Scheme (TFDS) for financing development and commercialisation of indigenous technology. Besides, under Risk Capital Scheme, RCTC started providing financial assistance to entrepreneurs by way of direct equity participation. Based on IFCI Venture's credentials and strengths, Unit Trust of India (UTI), entrusted RCTC with the management of a new venture capital fund named ***Venture Capital Unit Scheme (VECAUS-III)*** in 1991 with its funds coming from the UTI and IFCI. To reflect the shift in the company's activities, the name of RCTC was changed to IFCI Venture Capital Funds Ltd. (IFCI Venture) in February 2000.

In order to focus on Asset Management Activities, IFCI Venture discontinued Risk Capital and Technology Finance Schemes in 2000-01 and continued managing VECAUS-III. In 2007, as UTI had ceased to carry out its activities and its assets vested with *Specified Undertaking of the Unit Trust of India (SUUTI)*, the portfolio of VECAUS-III under management of IFCI Venture was transferred to SUUTI.

(iv) The Government of India had, on the recommendations of the National Committee on Tourism (Yunus Committee) set up under the aegis of Planning Commission, decided in 1988, to promote a separate All-India Financial Institution for providing financial assistance to tourism-related activities/projects. In accordance with the above decision, the IFCI Ltd. along with other All-India Financial/Investment Institutions and Nationalised Banks promoted a Public Limited Company under the name of "Tourism Finance Corporation of India Ltd. (TFCI)" to function as a Specialised All-India Development Financial Institution to cater to the financial needs of tourism industry.

TFCI was incorporated as a Public Limited Company in 1989 and became operational with effect in 1989. TFCI was notified as a Public Financial Institution in January 1990. Its promoter, the IFCI, holds major share (41.6 per cent) in it while the rest of the shares are with the 'public' (26 per cent),

public sector banks, public insurance companies and public mutual fund (i.e. UTI Mutual Fund Ltd.).

3. Investment Instituions (IIs)

Three investment institutions also came up in the public sector which are yet another kind of FIs i.e. the LIC (1956), the UTI (1964) and the GIC (1971).

In the present time they are no more considered as the FIs. The LIC is now the public sector insurance company in life segment, the GIC has been converted into a public sector re-insurance company and the UTI was converted into a mutual fund company in 2002.

Now these investment institutions (IIs) are no more like the past.The LIC is now called an 'insurance company', part of the Indian Insurance Industry and is the lone public sector playing in the life insurance segment. Similarly, the UTI is now part of the Indian Mutual Fund industry and the lone such firm in the public sector. This is why we do not get the use of the term 'IIs' in recent times in any of the GoI official documents.

4. State Level Finance Institutions (SLFIs)

In the wake of states involvement in the industrial development, the central government allowed the states to set up their own financial institutions (after the states demanded so). In this process two kinds of FIs came up:

(i) ***State Finance Corporations (SFCs)*****:** first coming up in Punjab (1955) and other states followed. At present there are 18 SFCs working

(ii) ***State Industrial Development Corporations (SIDCs)*****:** a fully dedicated state public sector FI to the cause of industrial development in the concerned states. First such FIs were set up (1960) in Andhra Pradesh and Bihar.

Almost all of the SFCs and SIDCs are at present running in huge losses. They may be re-structured on the lines of the AIFIs but there is lack of will from the states and private financiers who are not interested to go in for their takeovers as such.

MUTUAL FUND (MF)

Of all investment options, mutual funds are touted to be the best tool for wealth creation over the long term.They are of several types, and the risk varies with the kind of asset classes these funds invest in. As the name suggests, a mutual fund[7] *is a fund that is created when a large number of investors put in their money, and is managed by professionally qualified persons with experience in investing in different asset classes – shares, bonds, money market instruments like call money, and other assets such as gold and property.* Their names usually give a good idea about what type of asset class a fund, also called a scheme, will invest in. For example, a ***diversified equity fund*** will invest in a large number of stocks, while a ***gilt fund*** will invest in government securities while a ***pharma fund*** will mainly invest in stocks of companies from the pharmaceutical and related industries.

Mutual funds are compulsorily registered with the Securities and Exchange Board of India *(Sebi),*

which also acts as the ***first wall of defence*** for all investors in these funds. For those who do not understand how mutual funds operate but are willing to invest, the move by Sebi is seen as a big relief.

Each mutual fund is run by a group of qualified people who form a company, called an *asset management company (AMC)* and the operations of the AMC are under the guidance of another group of people, called *trustees*. Both, the people in the AMC as well as the trustees, have a *fiduciary responsibility* because these are the people who are entrusted with the task of managing the hard-earned money of people who do not understand much about managing money.

A fund house or a distributor working for the fund house (which could be an individual, a company or even a bank) are qualified to sell mutual funds. Once the fund house allots the 'units' of the MF to the investor at a price that is fixed through a process approved by Sebi which is based on the net asset value (NAV). In simple terms, NAV is the total value of investments in a scheme divided by the total number of units issued to investors in the same scheme. In most mutual fund schemes, NAVs are computed and published on a daily basis. However,when a fund house is launching a scheme for the first time, the units are sold at Rs 10 each.

There are **three types** of schemes offered by the MFs:

(i) *Open-ended Schemes:* An open-ended fund is the one which is usually available from a mutual fund on an ongoing basis, that is an investor can buy or sell as and when they intend to at a NAV-based price. As investors buy and sell units of a particular open-ended scheme, the number of units issued also changes every day and so changes the value of the scheme's portfolio. So, the NAV also changes on a daily basis. In India,fund houses can sell any number of units of a particular scheme, but at times fund houses restrict selling additional units of a scheme for some time.

(ii) *Closed-ended Schemes:* A close-ended fund usually issue units to investors only once, when they launch an offer, called *new fund offer (NFO)* in India. Thereafter, these units are listed on the stock exchanges where they are traded on a daily basis. As these units are listed, any investor can buy and sell these units through the exchange. As the name suggests, close-ended schemes are managed by fund houses for a limited number of years, and at the end of the term either money is returned to the investors or the scheme is made open ended. However, there is a word of caution here that usually, units of close ended funds which are listed on the stock exchanges, trade at a high discount to their NAVs. But as the date for closure of the fund nears, the discount between the NAV and the trading price narrows, and vanishes on the day of closure of the scheme.

(iii) *Exchange-Traded Funds (ETFs):* ETFs are a mix of open-ended and close-ended schemes. ETFs, like close-ended schemes, are listed and traded on a stock exchange on a daily basis, but the price is usually very close to its NAV, or the underlying assets, like gold ETFs.

If investment have been done in a well-managed MF, the advantages outweigh disadvantages and in the long term, which is 10 years or more. There is a very high probability for investors of making more money than by investing in other risk-free investments such as FDs, public provident fund, etc. Advantages of investing in MFs include diversification, good investment management services, liquidity, strong government-backed regulatory help, professional service, and all these at a low cost. An investor, by investing in a mutual fund scheme that has blue chip stocks in its portfolio, indirectly

gets an exposure to these stocks. Compared to this, if the same investor wants to have each of these stocks in his portfolio, the cost of buying and managing the portfolio will be much higher.

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1. Based on the discussion in Samuelson and Nordhaus, ***Economics,*** op.cit., pp. 543–545.
2. Based on Stiglitz and Walsh, ***Economics,*** op.cit., pp. 612–14.
3. Reports on Currency and Finance, RBI, GoI, N. Delhi.
4. Reports on Currency and Finance, RBI, GoI, N. Delhi, 2002.
5. Based on the various Reports of the RBI.
6. **Annual Report of RBI**, GoI, N. Delhi, 2006.
7. **India 2013,** Pub. Div., GoI, N. Delhi, pp. 340-342.
8. **Industrial Policy Resolution, 1956,** MoI, GoI, N. Delhi.
9. **Economic Survey 2012–13** MoF, GoI, N. Delhi. p. 116.
10. In the capital market, money is traded on ***interest rate*** as well as on ***dividends***. Long-term loans are raised on well-defined interest rates while long-term capital is raised on dividends through the sale of shares.
11. Such financial assets are known as 'close substitutes for money'.
12. The only instrument of the money market was the Treasury Bills which were sold by tender at weekly auctions upto 1965. But after that these bills were made available throughout the week at discount rate by the RBI (***Suraj B. Gupta, Monetary Economics***, S. Chand, N. Delhi, 2007, p. 50).
13. ***Review of the Working of the Monetary System*** headed by Sukhomoy Chakravarthy, RBI, N. Delhi, 1985.
14. ***Working Group on Money Market*** (Vaghul Committee), RBI, N. Delhi, 1987 (headed by M. Vaghul, The chairman ICICI, set up 1986).
15. Based on the suggestions of the experts belonging to the Indian financial market.
16. ***Economic Survey 2001–02*** & ***2009–2010*** MoF, GoI, N. Delhi.
17. ***Report on Currency and Finance 1999–2000***, RBI, GoI, N. Delhi.
18. It was in 1979 that the ***Chore Committee*** first time recommended for a discount house to level the liquidity imbalances in the banking system. The Government became active after the recommendations of the Working Group on the Money Market (***i.e. the Vaghul Committee, 1987***) and did set up the DFHI in 1988. The Vaghul Committee suggested to set up a discount finance institution which could deal in the short-term money market instruments so that liquidity could be provided to these instruments. The committee also recommended the house to ***operate on commercial basis*** which was accepted by the Government while setting up the DFHI.
19. ***Economic Survey 2011-12,*** op. cit., p. 96.
20. ***Industrial Finance Corporation of India*** **Act,** ***1948***, GoI, N. Delhi.
21. ***Economic Survey 2000–01***, MoF, GoI, N. Delhi.
22. ***Economic Survey 2006–07,*** MoF, GoI, N. Delhi.
23. It was the ***Narasimhan Committee on the Financial System (CFS).*** 1991 which suggested for the conversion of the AIFIs into the Development Bank.
24. It was the ***S.H. Khan Committee on the Development Financial Institutions (DFIs)***, 1998 which forwarded the concept/idea of Universal Banking in India.
25. ***Economic Survey 2011-12,*** op. cit., p. 115-116.
26. The write-up is based on the information made available by the ***SEBI, RBI*** and different releases of the ***Ministry of Finance,*** GoI, N. Delhi, since 1996 onwards.

12

BANKING IN INDIA

*Banks are perhaps the most important financial intermediary. In the nineteenth century, banks mainly lent money to firms to help finance their inventories – which were held as collateral – in the cases of defaulters banks seized them. Gradually, banks expanded their lending activities – to finance houses and commercial real estates – holding the buildings as collateral. Emergence of the information technology has presented special problems to these traditional forms of finance – if the idea does not pan out, the firm may go bankrupt, but there is no collateral – there is little of value that the creditor can seize.**

- Introduction
- Bank & Non-Bank Institutions
- Non-Banking Financial Companies (NBFCs)
- Reserve Bank of India
- Base Rate
- Nationalisation and Development of Banking
- Financial Sector Reforms
- Banking Sector Reform
- New Rules for Opening Banks
- The Menace of NPAs
- Capital Adequacy Ratio
- Why to maintain CAR?
- Non-Resident Indian Deposits

** See Joseph E Stiglitz and Carl E Walsh, Economics, W W Norton, New Yok, USA, 4th Edition, 2006, p. 205.*

INTRODUCTION

The sense in which we today use the term banking has its origin in the western world to which India was introduced by the British rulers, way back in the 17th century. Since then, enough water has flown and today Indian banks are considered among the best banks in the developing world and its attempts to emerge among the best in the world is going on as the *Union Budget 2007-08* said.

BANK & NON-BANK INSTITUTIONS

A financial institution which accepts different forms of deposits and lends them to the prospective borrowers as well as allows the depositors to withdraw their money from the accounts by cheque is a ***bank***.

If the financial institution has all the same functions but does not allow depositors to issue cheque and withdraw their money from deposits then it is a ***non-bank institution.***

NON-BANKING FINANCIAL COMPANIES (NBFCS)

A non-banking financial company (NBFC) is a company[1] registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but ***does not include*** any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.

A non-banking institution which is a company and which has its principal business of receiving *deposits* under any scheme or arrangement or any other manner, or lending in any manner is also a non-banking financial company (residuary non-banking company i.e. RNBC).

NBFCs are doing functions akin to that of banks, however there are a few differences:

(i) An NBFC cannot accept demand deposits (which are payable on demand), like the *savings* and *current accounts*.

(ii) It is not a part of the payment and settlement system and as such *cannot issue cheques* to its customers; and

(iii) Deposit insurance facility is not available for NBFC depositors unlike in case of banks (It means the public deposits with them are 'unsecured'. In case a NBFC defaults in repayment of deposit, the depositor can approach Company Law Board or Consumer Forum or file a civil suit to recover the deposits).

Under the RBI Act, 1934, the NBFCs have to get registered with RBI. However, to obviate ***dual regulation***, certain category of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI such as:

(i) venture capital fund, merchant banking companies, stock broking companies register with Sebi;

(ii) insurance company holding a valid certificate of registration issued by IRDA;

(iii) *nidhi* companies under the Companies Act, 1956;

(iv) chit companies under the Chit Funds Act, 1982;

(v) housing finance companies regulated by National Housing Bank (of the RBI).

A company incorporated under the Companies Act, 1956 and desirous of commencing business of the NBFC should have a minimum net owned fund (NOF) of Rs 25 lakh (raised to Rs 2 crore from April 21, 1999). NBFCs registered with RBI have been reclassified (since 2006) as – the Asset Finance Company (AFC); Investment Company (IC); and the Loan Company (LC). ***Provisions*** for accepting deposits are:

- There is ceiling on acceptance of public deposits an NBFC maintaining required NOF and CRAR and complying with the prudential norms can accept public deposits maximum upto 4 times of NOF;
- Can offer the maximum 11% rate of interest;
- Minimum investment grade credit rating (MIGR) is essential (may get itself rated by any of the four rating agencies namely, CRISIL, CARE, ICRA and FITCH Ratings India Pvt. Ltd.);
- Are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months; and
- Effective from April 2004, cannot accept deposits from NRIs except deposits by debit to NRO account of NRIs provided such amount do not represent inward remittance or transfer from NRE/FCNR (B) account, however, the existing NRI deposits can be renewed *(**Note**: different foreign currency accounts opened by the Indian banks have been given as the last sub-topic of this Chapter).*

There is no ceiling on raising of deposits by RNBCs but every RNBC has to ensure that the amounts deposited and investments made by the company are not less than the aggregate amount of liabilities to the depositors. To secure the interest of depositors, such companies are required to invest in a portfolio comprising of highly liquid and secured instruments viz. Central/State Government securities, fixed deposit of scheduled commercial banks (SCB), Certificate of deposits of SCB/FIs, units of Mutual Funds, etc. The amount payable by way of interest, premium, bonus or other advantage, by whatever name called by them in respect of deposits received shall not be less than the amount calculated at the rate of 5% (to be compounded annually) on the amount deposited in lump sum or at monthly or longer intervals; and at the rate of 3.5% (to be compounded annually) on the amount deposited under daily deposit scheme. Further, an RNBC can accept deposits for a minimum period of 12 months and maximum period of 84 months from the date of receipt of such deposit. Like the NBFCs they cannot accept deposits repayable on demand (it means they, too can not open saving and current accounts).

RESERVE BANK OF INDIA

The Reserve Bank of India (RBI) was set up in 1935 (by the *RBI Act, 1934*) as a private bank with two extra functions—regulation and control of the banks in India and being the banker of the Government. After nationalisation in 1949, it emerged as the central banking body of India and it did not remain a 'bank' in the technical sense. Since then, the governments have been handing over different functions[2] to the RBI which stand today as given below:

(i) It is the issuing agency of the currency and coins other than rupee one currency and coin (which are issued by the Ministry of Finance itself with the signature of the Revenue Secretary on the note).

(ii) Distributing agent for the currency and coins issued by the Government.

(iii) Banker of the Government.

(iv) Bank of the banks/Bank of the last resort.

(v) Announces the credit and monetary policy for the economy.

(vi) Stabilising the rate of inflation.

(vii) Stabilising the exchange rate of rupee.

(viii) Keeper of the foreign currency reserves.

(ix) Agent of the Government of India in the IMF.

(x) Performing a variety of developmental and promotional functions under which it did set up institutions like IDBI, SIDBI, NABARD, NHB, etc.

Credit and Monetary Policy

The policy by which the desired level of money flow and its demand is regulated is known as the credit and monetary policy. All over the world it is announced by the central banking body of the country—as the RBI announces it in India. In India there has been a tradition of announcing it twice in a financial year—before the starting of the *busy* and the *slack* seasons. But in the reform period, this tradition has been broken. Now the RBI keeps modifying this as per the requirement of the economy, though the practice of the two policy announcements a year still continues.

In India, a debate regarding autonomy to the RBI regarding announcement of the policy started when the Narasimham Committee-I recommended on these lines. As the Governor RBI it was Bimal Jalan who vocally supported the idea. No such move came from the governments officially but it is believed that the RBI has been given almost working autonomy in this area. In most of the developed economies, the central bank functions with autonomous powers in this area (bifurcation of politics from the economics). Though we lack such kind of officially open autonomy for the RBI, we have learnt enough by now and are better off today.

There are many tools by which the RBI regulates the desired/required kind of the credit and monetary policy—CRR, SLR, Bank Rate, Repo rate, Reverse Repo rate, PLR, Exim interest rate, Small Saving Schemes' interest rates (SSSs), interest changes for the instruments of the Money Market, etc.

CRR

The cash reserve ratio (CRR) is the ratio (fixed by the RBI) of the total deposits of a bank in India which is kept with the RBI in cash form. This was fixed to be in the range of 3 to 15 per cent.[3] A

recent Amendment (2007) has removed the 3 per cent floor and provided a free hand to the RBI in fixing the CRR.

At present it is 4.75 per cent and a 1 per cent change in it today affects the economy with `64,000 crore[4] —an increase sucks this amount from the economy while a decrease injects this amount into the economy.

Following the recommendations of the Narasimham Committee on the Financial System (1991) the Government started two major changes concerning the CRR:

(i) reducing the CRR was set as the medium-term objective and it was reduced gradually from its peak of 15 per cent in 1992 to 4.5 per cent by June 2003[5].

After the RBI (Amendment) Act has been enacted in June 2006, the RBI can now prescribe CRR for scheduled banks without any floor or ceiling rate thereby removing the statutory minimum CRR limit of 3 per cent.[6]

(ii) Payment of interest by the RBI on the CRR money to the scheduled banks started in financial year 1999–2000 (in the wake of banking slow down). Though the RBI discontinued interest payments from mid-2007.[7]

SLR

The statutory liquidity ratio (SLR) is the ratio (fixed by the RBI) of the total deposits of a bank which is to be maintained by the bank with itself in non-cash form prescribed by the Government to be in the range of 25 to 40 per cent.[8]

At present it is 25 per cent (done in October, 1997 after CFS suggestions)[9]. It used to be as high as 38.5 per cent. The CFS has recommended the Government not to use this money by handing G-Secs to the banks. In its place a ***market-based interest*** on it should be paid by the Government it was being advised. However, there has been no follow up in this regard by the governments. The Government of India has removed the 25 per cent floor for the SLR by an Amendment (2007) providing the RBI a free hand in fixing it.

Bank Rate

The interest rate which the RBI charges on its **long-term** lendings is known as the Bank Rate. The clients who borrow through this route are the GoI, State governments, Banks, Financial Institutions, Co-operative Banks, NBFCs, etc. The rate has direct impact on the long-term lending activities of the concerned lending bodies operating in the Indian financial system. Tha rate was realigned[10] with the MSF (Marginal Standing Facility) by the RBI in February, 2012.

Repo Rate

The rate of interest the RBI charges from its clients on their ***short-term*** borrowing is the repo rate in India which is at present 8 per cent.[11] Basically, this is abbreviated form of the 'rate of repurchase' and in western economies it is known as the 'rate of discount'.[12]

In practice it is not called an interest rate but considered a discount on the dated Government

Securities which are deposited by the institution to borrow for the short term. When they get their securities released from the RBI, the value of the securities is lost by the amount of the current repo rate. This rate functions as the benchmark rate for the inter-bank short-term market (i.e. Call Money Market) in India. Banks usually use this route for one-day borrowing to fulfill their short-term liquidity crunch. Higher the repo rate costlier the loans banks forward and vice versa. It has direct impact on the *nominal interest* rates of the bank's lending. The ***repo rate*** was introduced in December 1992.

Reverse Repo Rate

It is the rate of interest the RBI pays to its clients who offer short term loan to it.

It is reverse of the repo rate and this was started in November 1996 as part of Liquidity Adjustment Facility (LAF) by the RBI. In practice, financial instituions operating in India park their surplus funds with the RBI for short-term period and earn money. It has a direct bearing on the interest rates charged by the banks and the financial institutions on their different forms of loans.

This tool was utilised by the RBI in the wake of over money supply with the Indian banks and lower loan disbursal to serve twin purposes of cutting down banks losses and the prevailing interest rate[13]. It has emerged as a very important tool in direction of following cheap interest regime—the general policy of the RBI since reform process started.

Marginal Standing Facility (MSF) [14]

MSF is a new scheme announced by the RBI in its Monetary Policy, 2011-12 which came into effect from 9th May 2011. Under this scheme, banks can borrow overnight upto 1 per cent of their net demand and time liabilities (NDTL) from the RBI, at the interest rate 1 per cent (100 basis points) higher than the current repo rate.

The MSF would be the last resort for banks *once they exhaust* all borrowing options including the liquidity adjustment facility by pledging through government securities, which has lower rate (i.e. repo rate) of interest in comparison with the MSF. The MSF would be a **penal rate** for banks and the banks can borrow funds by pledging government securities within the limits of the statutory liquidity ratio. The scheme has been introduced by RBI with the main aim of reducing volatility in the overnight lending rates in the inter-bank market and to enable smooth monetary transmission in the financial system.

Banks can borrow through MSF on all working days except Saturdays, between 3.30 and 4 30 pm in Mumbai where RBI has its headquarters. The minimum amount which can be accessed through MSF is Rs.1 crore and in multiples of Rs.1 crore.

MSF represents the upper band of the interest corridor and reverse repo (7.25 per cent) as the lower band and the repo rate in the middle. To balance the liquidity, RBI would use the sole independent policy rate which is the repo rate and the MSF rate automatically adjusts to 1 per cent above the repo rate.

Similar to India's MSF the ECB (European Central Bank) also offers standing facilities called *marginal lending facilities* (MLF) and the Federal Reserve (the US Central Bank) has *discount window systems* (DWS). Like the MSF, the secondary credit facility made available by the Federal

Reserve to the depository institutions in USA is typically overnight credit on a very short term basis at rates above the primary credit rate.

The effectiveness of standing facilities in reducing volatility have been examined by many scholars and certain studies have pointed out that in the Federal Reserve System in the United States, the design of the facility decreases a bank's incentive to participate actively in *interbank market* (i.e. India's Call Money Market) due to the perceived stigma from using such facility. This in turn reduces the effectiveness of standing facility in reducing interest rate volatility.

Bank Rate realigned with MSF

The RBI on February 15, 2012 increased the Bank Rate by 350 basis points from 6 per cent to 9.50 per cent and realigned the Bank Rate with Marginal Standing Facility (MSF) rate, which, in turn, is linked to the policy repo rate[15]. Henceforth, whenever there is an adjustment of the MSF rate, the RBI will consider and align the Bank Rate with the revised MSF rate.

Being the discount rate, the Bank Rate should technically be higher than the policy repo rate. The Bank Rate has, however, been kept unchanged at 6 per cent since April 2003. This was mainly for the reason that monetary policy signalling was done through modulations in the reverse repo rate and the repo rate till May 3, 2011, and the policy repo rate under the revised operating procedure of monetary policy from May 3, 2011 onwards.

Moreover, under the revised operating procedure, MSF, instituted at 100 basis points above the policy repo rate, has been in operation, which more or less served the purpose of the Bank Rate. At present, the repo rate is 8.50 per cent, reserve repo 7.50 per cent and MSF 9.50 per cent. Repo rate is the rate at which banks borrow funds from the RBI and reverse repo rate is the rate at which banks park their funds with the RBI. Under the MSF, banks are permitted to avail themselves of funds from the RBI on overnight basis.

The Bank Rate acts as the **penal rate** charged on banks for shortfalls in meeting their reserve requirements (CRR and SLR)). The Bank Rate is also used by several financial institutions as a reference rate for indexation purposes.

BASE RATE

Base Rate is the interest rate below which Scheduled Commercial Banks (SCBs) will lend no loans to its customers - its means it is like Prime Lending Rate (PLR) and the Benchmark Prime lending Rate (BPLR) of the past and is basically a floor rate of interest. It replaced[16] the existing idea of BPLR on July 1, 2010.

The BPLR system (while the existing system was of PLR), introduced in 2003, fell short of its original objective of *bringing transparency* to lending rates. This was mainly because under this system, banks could lend below BPLR.This made a bargaining by the borrower with bank- ultimately one borrower getting cheaper loan than the other, and blurred the attempts of bringing in transparency in the lending business. For the same reason, it was also difficult to assess the transmission of *policy rates* (i.e. repo rate, reverse repo rate, bank rate) of the Reserve Bank to lending rates of banks. The

Base Rate system is **aimed at** enhancing transparency in lending rates of banks and enabling better assessment of transmission of monetary policy. To look into this matter the RBI constituted a Working Group on Benchmark Prime Lending Rate (chaired Deepak Mohanty) to review the present benchmark prime lending rate (BPLR) system and suggest changes to make credit pricing more transparent- report submitted in October 2009 and accordingly the idea of Base rate was implemented.

Now, all categories of loans are priced with reference to the Base Rate only, except the- (a) Differential rate of Interest (DRI) loans (b) loans to banks' own employees, and (c) loans to banks' depositors against their own deposits. Since the Base Rate will be the minimum rate for all loans, banks are not permitted to resort to any lending below this rate- accordingly, the provision of lending below the BPLR to a customer by banks if the loan amount is not less than Rs. 2 lakh has been withdrawn. It is expected that the above **deregulation** of lending rate will increase the credit flow to small borrowers at reasonable rate and direct bank finance will provide effective competition to other forms of high cost credit. For export credit, RBI announces the floor rate, separately. Banks are required to review the Base Rate at least once in a quarter and publish the same for the general public.

Current Credit & Monetary Policy

As per the ***Annual Monetary Policy Statement 2013-14 of the RBI*** (announced on 3rd May, 2013) the key rates of the Credit & Monetary Policy stands as given below –

1. **Policy Rates:**
   - Bank Rate – 8.25%
   - Repo Rate – 7.25%
   - Reverse Repo Rate – 6.25%
   - Marginal Standing Facility Rate – 8.25%
2. **Reserve Ratios:**
   - Cash Reserve Ratio – 4%
   - Statutory Liquidity Ratio – 23%
3. **Lenidng / Deposit Rates:**
   - Base Rate – 9.70%- 10.25%
   - Saving Deposit Rate – 4.0% (relates to 5 major banks)
   - Term Deposit Rate – 7.5% - 9.00%

As the 'headline inflation' rate of India is presently (**April 15, 2013**) at a ***three-year low*** of 5.96 per cent (in Dec. 2009, it was at 4.95 per cent) the business and industry in the country is hopeful of cuts in the CRR as well as the Repo rate by the RBI when the Central bank announces its ***Annual Policy Statement,*** end-May, 2013. Experts together with the major bankers of the country also believe this action imminent from the RBI as the slackening growth rate of the economy needs some 'boosting' from the interest rate side.

NATIONALISATION AND DEVELOPMENT OF BANKING

The development of banking industry in India has been intertwined with the story of its nationalisation. Once the Reserve Bank of India (RBI) was nationalised in 1949 and a central banking was in place the government considered the nationalising of selected private banks in the country due to the following ***major*** reasons:

(i) As the banks were owned and managed by the private sector the services of the banking were having a narrow reach—the masses had no access to the banking service;

(ii) The Government needed to direct the resources in such a way that greater public benefit could take place;

(iii) The planned development of the economy required a certain degree of government control on the capital generated by the economy. Nationalisation of banks in India took place in the following two stages:

1. Emergence of the SBI

The Government of India, with the enactment of the *SBI Act, 1955* ***partially nationalised*** the three Imperial Banks (mainly operating in the three Presidencies of past with their 466 branches) and named them the State Bank of India—the first public sector bank emerged in India. The RBI had purchased 92 per cent of the shares in this partial nationalisation.

Satisfied with the experiment, the Government in a related move ***partially nationalised*** eight more private banks (with good regional presence) via *SBI (Associates) Act, 1959* and named them as the Associates of the SBI—the RBI had acquired 92 per cent stake in them as well. After merging the State Bank of Bikaner and the State Bank of Jaipur as well, the RBI came up with the State Bank of Bikaner and Jaipur. Now the SBI Group has a total number of Six banks—SBI being one and Five of its Associates.

2. Emergence of Nationalised Banks

After successful experimentation in the partial nationalisations the Government decided to go for complete nationalisation. With the help of the *Banking Nationalisation Act, 1969,* the Government nationalised a total number of 20 private banks:

(i) 14 banks with deposits more than ` 50 crore nationalised in July 1969, and

(ii) 6 banks with deposits more than ` 200 crore nationalised in April 1980.

After the merger of the loss-making New Bank of India with the Punjab National Bank (PNB) in September 1993, the total number of the nationalised banks came down to 19. Today, there are 27 public sector banks in India out of which 19 are nationalised (though none of the so-called nationalised banks have 100 per cent ownership of the Government of India).

After the nationalisation of banks the Government *stopped* opening of banks in the private sector though some foreign private banks were allowed to operate in the country to provide the external currency loans. After India ushered in the era of the economic reforms, the Government started a

comprehensive banking system reform in the fiscal 1992–93. Three related developments allowed the further expansion of banking industry in the country:

(i) In 1993 the SBI was allowed access to the capital market with permission given to sell its share to the tune of 33 per cent through *SBI (Amendment) Act, 1993*.

At present the Government of India has 59.73 per cent shares in the SBI (*It was on July 9, 2007 that the entire equity stake of RBI was taken over by the Government of India. Thus, the RBI is no more the holding bank of the SBI and its Associates*.).

On October 10, 2007 the Government announced its proposal of selling the shares of the SBI and cutting down its stake in it to 53 per cent level so that the bank can go for capitalisation.

(ii) In 1994 the Government allowed the nationalised banks to have the access to the capital market with a ceiling of 33 per cent sale of shares through the *Banking Companies (Amendment) Act, 1994*.

Since then many nationalised banks have tapped the capital market for their capital enhancement—Indian Overseas Bank being the first in the row. Though such banks could be better called the public sector banks (as the GoI holds more than 50 per cent stake in them) they are still known as the nationalised banks.

(iii) In 1994 itself the Government allowed the opening of private banks in the country. The first private bank of the reform era was the UTI Bank. Since then a few dozens Indian and foreign private banks have been opened in the country.

Thus, since 1993–94 onwards, we see a reversal of the policies governing banks in the country. As a general principle, the public sector and the nationalised banks are to be converted into private sector entities. What would be the minimum government holding in them is still a matter of debate and yet to be decided.[17] The policy of bank consolidation is still being followed by the government, so that these banks could broaden their capital base and emerge as significant players in the global banking competition.[18] Every delay in it will hamper their interests, as per the experts.

3. Emergence of the RRBs

The Regional Rural Banks (RRBs) were first set up on October 2, 1975 (only 5 in numbers) with the aim to take banking services to the doorsteps of the rural masses specially in the remote areas with no access to banking services with twin duties to fulfill:

(i) to provide credit to the weaker sections of the society at concessional rate of interest who previously depended on private money lending and

(ii) to mobilise rural savings and channelise them for supporting productive activities in the rural areas.

Following the suggestions of the *Kelkar Committee*, the government stopped opening new RRBs in 1987 – by that time their total number stood at 196. Due to excessive leanings towards social banking and catering to the highly economically weaker sections, these banks started incurring huge losses by early 1980s. For restructuring and strengthening of the banks, the governments set up two committees – the *Bhandari Committee* (1994–95) and the *Basu Committee* (1995–96). Out of the total, 171 were running in losses in 1998–99 when the government took some serious decisions**:**

(i) the obligation of concessional loans abolished and the RRBs started charging commercial interest rates on its lendings.

(ii) the target clientele (rural masses, weaker sections) was set free now to lend to any body.

After the above-given policy changes, the RRBs started coming out of the red/losses. The CFS has recommended to get them merged with their managing nationalised or public sector banks and finally make them part of the would-be three-tier banking structure of India. At present there are 82 RRBs (46 amalgamated and 36 standalone) functioning in India even though the amalgamation process is going on (*India 2013*).

FINANCIAL SECTOR REFORMS

The process of economic reforms initiated in 1991 had redefined the role of government in the economy—in coming times the economy will be dependent on the greater private participation for its development.[19] Such a changed view to development required an overhauling in the investment structure of the economy. Now the private sector was going to demand high investible capital out of the financial system. Thus, an emergent need was felt to restructure the whole financial system of India.

The three decades after nationalisation had seen a phenomenal expansion in the geographical coverage and financial spread of the banking system in the country. As certain weaknesses were found to have developed in the system during the late eighties, it was felt that these had to be addressed to enable the financial system to play its role ushering in a more efficient and competitive economy.[20] Accordingly, a ***high level*** Committee on Financial System (CFS) was set up on August 14, 1991 to examine all aspects relating to ***structure, organisation, function*** and ***procedures*** of the financial system—based on its recommedations, a comprehensive reform of the banking system was introduced in the fiscal 1992–93.[21]

The CFS based its recommendations on certain ***assumptions***[22] which are basic to the banking industry. And the suggestions of the committee became logical in light of this assumption, there is no second opinion about it. The assumption says that ***"the resources of the banks come from the general public and are held by the banks in trust that they are to be deployed for maximum benefit of the depositors".*** This assumption automatically implied:

(i) That even the Government had no business to endanger the solvency, health and efficiency of the nationalised banks under the pretext of using banks, resources for ***economic planning, social banking, poverty alleviation,*** etc.

(ii) Besides, the Government had no right to get hold of the funds of the banks at low interest rates and use them for financing its consumption expenditure (i.e revenue and fiscal deficits) and thus defraud the depositors.

The recommendations of the CFS (**Narasimham Committee I**) were ***aimed*** at:

(i) Ensuring a degree of operational ***flexibility;***

(ii) ***internal autonomy*** for public sector banks (PSBs) in their decision making process; and

(iii) greater degree of ***professionalism*** in banking operation.

Recommendation of CFS

The CFS recommondation[23] could be summed up under five sub-titles:

1. On Directed Investment:

The RBI was advised not to use the CRR as a principal instrument of monetary and credit control, in place it should rely on open market operations (OMOs) increasingly. Two proposals advised regarding the CRR:

(i) CRR should be progressively reduced from the present high level of 15 per cent to 3 to 5 per cent; and

(ii) RBI should pay interest on the CRR of banks above the basic minimum at a rate of interest equal to the level of banks, one year deposit.

Concerning the SLR it was advised to cut it to the minimum level (i.e. 25 per cent) from the present high level of 38.5 per cent in the next 5 years (it was cut down to 25 per cent in October 1997). The Government was also suggested to progressively move towards market-based borrowing programme so that banks get economic benefits on their SLR investments.

These suggestions were directed to the goal of making more funds available to the banks, converting idle cash for use, and cutting down the interest rates banks charge on their loans.

2. On Directed Credit Programme:

Under this sub-title the suggestions revolved around the compulsion of priority sector lending (PSL) by the banks:

(i) Directed credit programme should be phased out gradually. As per the committee, agriculture and small scale industries (SSIs) had already grown to a mature stage and they did not require any special support; two decades of interest subsidy were enough. Therefore, concessional rates of interest could be dispensed with.

(ii) Directed credit should not be a regular programme—it should be a case of extraordinary support to certain weak sections—besides, it should be temporary, not a permanent one.

(iii) Concept of PSL should be redefined to include only the weakest sections of the rural community such as marginal farmers, rural artisans, village and cottage industries, tiny sector, etc.

(iv) The "redefined PSL" should have 10 per cent fixed of the aggregate bank credit.

(v) The composition of the PSL should be reviewed after every 3 years.

3. On the Structure of Interest Rates:

The major recommendations on the structure of interest rates are:

(i) Interest rates to be broadly determined by market forces;

(ii) All controls of interest rates on deposits and lending to be withdrawn;

(iii) Concessional rates of interest for PSL of small sizes to be phased out and subsidies on the

IRDP loans to be withdrawn;

(iv) Bank rate to be the anchor rate and all other interest rates to be closely linked to it; and

(v) The RBI to be the sole authority to simplify the structure of interest rates.

4. On Structural Reorganisation of the Bank:

For the structural reorganisation of banks some major suggestions were given:

(i) Substantial reduction in the number of the PSBs through mergers and acquisitions—to bring about greater efficiency in banking operations;

(ii) Dual control of RBI and Banking Division (of the Ministry of Finance) should go immediately and RBI to be made the primary agency for the regulation of the banking system;

(iii) The PSBs to be made free and autonomous;

(iv) The RBI to examine all the guidelines and directions issued to the banking system in the context of the independence and autonomy of the banks;

(v) Every PSB to go for a radical change in work technology and culture, so as to become competitive internally and to be at par with the wide range of innovations taking place abroad; and

(vi) Finally, the appointment of the Chief Executive of Bank (CMD) was suggested not to be on political considerations but on professionalism and integrity. An independent panel of experts was suggested which should recommend and finalise the suitable candidates for this post.

5. Asset Reconstruction Companies/Fund:

To tackle the menace of the higher non-performing assets (NPAs) of the banks and the financial institutions, the committee suggested setting up of the asset reconstruction companies/funds (taking clue from the US experience).

The committee directly blamed the Government of India (GoI) and the Ministry of Finance for the sad state of affairs of the PSBs. These banks were used and abused by the GoI, the officials, the bank employees and the trade unions, the report adds. The recommendations were revolutionary in many respects and were opposed by the bank unions and the leftist political parties.

There were some other major suggestions of the committee which made it possible to get the following[24] things done by the Government:

(i) opening of new private sector banks permitted in 1993;

(ii) prudential norms relating to income recognition, asset classification and provisioning by banks on the basis of objective criteria laid down by the RBI;

(iii) the introduction of the capital adequacy norms (i.e. CAR provisions) with international standard started;

(iv) simplification in the banking regulation (i.e. via board for financial supervision in 1994); etc.

BANKING SECTOR REFORM

The government commenced a comprehensive reform process in the financial system in 1992–93 after the recommendations of the CFS in 1991. In December 1997 the Government did set up another committtee on the banking sector reform under the chairmanship of M. Narasimham.[25] The objective of the committee is objectively clear by the ***terms of reference*** it was given while setting up—

"To review the progress of banking sector reforms to date and chart a programme of financial sector reforms necessary to strengthen India's financial system and make it internationally competitive"

The **Narasimham Committee-II** (Popularly called by the Government of India) handed over its reports in April 1998 which included the following major suggestions[26] :

(i) Need for a stronger banking system for which mergers of the PSBs and the financial Institutions (AIFIs) were suggested—stronger banks and the DFIs (development financial institutions i.e. AIFIs) to be merged while weaker and unviable ones to be closed.

(ii) A 3-tier banking structure was suggested after mergers:

- ***Tier-1*** to have 2 to 3 banks of international orientation;
- ***Tier-2*** to have 8 to 10 banks of national orientation; and
- ***Tier-3*** to have a large number of local banks.

The first and second tiers were to take care of the banking needs of the corporate sector in the economy.

(iii) Higher norms of Capital-to-Risk—Weighted Adequacy Ratio (CRAR) suggested—increased to 10 per cent.

(iv) Budgetary recapitalisation of the PSBs is not viable and should be abandoned.

(v) Legal framework of loan recovery should be strengthened (the government passed the *SARFAESI (Act, 2002*).

(vi) Net NPAs for all banks suggested to be cut down to below 5 per cent by 2000 and 3 per cent by 2002.

(vii) Rationalisation of branches and staffs of the PSBs suggested.

(viii) Licencing to new private banks (domestic as well as foreign) was suggested to continue with.

(ix) Banks' boards should be depoliticised under RBI supervision.

(x) Board for financial Regulation and Supervisions (BFRS) should be set up for the whole banking, financial and the NBFCs in India[27].

NEW RULES FOR OPENING BANKS

The Reserve Bank of India announced the much-awaited new eligibility criteria for opening new banks in India by the private entities, in September 2011 and finalised in February 2013, after cousidering advices and suggestions formthe business and industry.

The issue of giving licences to a few private parties to start commercial banks has always been a sensitive one. More so, at this juncture, when it is believed that the new policy relaxation is primarily for the benefit of large industrial houses and business groups. Before 1969, many leading banks,

including Bank of India, Bank of Baroda and United Commercial Bank, were owned or controlled by leading business groups. In a two-stage process that began in 1969, the government nationalised these banks in a decision that had as much to do with domestic politics as economics. The case for the takeover was built on the ground that these banks were serving their private promoters' interests and that in any case there was a need to reorient the banking system towards national interests (a period of social control of banks preceded their takeover). The bias against large industrial houses has continued in the reform era. Following the guidelines of 1993 and 2001, some private banks came into being but none of them was sponsored by large business houses. However, this time it is likely that a few industrial houses will make the grade. The rules are as given beow:

Eligible promoters: Entities/groups in the private sector, owned and controlled by residents, with diversified ownership, sound credentials and integrity and having successful track record of at least ten years will be eligible to promote banks. In a significant move, the RBI has barred groups having even an exposure of 10 per cent (by way of assets or income or both) in real estate and/or broking activities over the past three years. Evidently, these sectors are 'speculative' in nature and the business model adopted in such businesses will be 'misaligned' with that required by a bank.

Corporate structure: New banks will be set only through a wholly-owned non-operative holding company (NOHC), which will be registered with the RBI as a non-banking finance company. All financial activities of the promoter group will come under the NOHC. The idea is to ring fence the financial interests of the group from its other business activities and give a measure of protection to the bank's depositors.

Capital Requirement: It will be Rs.500 crore. The NOHC will hold a minimum 40 per cent of the capital for five years from the date of licensing and aggregate non-resident shareholding will not exceed 49 per cent for the first five years.

Corporate governance: 50 per cent of the directors of the NOHC should be independent directors.

Business Model: should be realistic and viable and should address how the bank proposes to achieve financial inclusion, bank should have a fourth of its branches in unbanked rural areas. The RBI will have the powers to vet the business plan and pull up the promoters for any deviations.

Amendment: to the Banking Regulation Act, 1949, will be carried out to give the central bank extensive powers in a wide range of matters necessary for effective supervision.

Listing on Stock Exchanges: The bank shall get its shares listed on the stock exchanges within two years of licensing.

DRI

The differential rate of interest (DRI) is a lending programme launched by the government in April 1972 which makes it obligatory upon all the public sector banks in India to lend 1 per cent of the total lending of the preceding year to ***'the poorest among the poor'*** at an interest rate of 4 per cent per annum. The total lending in 2005–06 was ` 351 crores.

Priority Sector Lending

All Indian banks have to follow the compulsory target of priority sector lending (PSL). The priority

sector in India are at present the sectors—agriculture, small and medium enterprises (SMEs), road and water transport, retail trade, small business, small housing loans (not more than Rs. 10 lakhs), software industries, Self Help Groups (SHGs), agro-processing, small and marginal farmers, artisans, distressed urban poor and indebted non-institutional debtors besides the SCs, STs and other weaker sections of society.[28] The 5 minorities, namely the ***Muslims, Christians, Sikhs, Buddhists*** and ***Parsis*** have been included under the PSL.[29] The PSL target must be met by the banks operating in India in the following way:

(i) ***Indian Banks*** need to lend 40 per cent to the priority sector every year (public sector as well as private sector banks, both) of their total lending. There is a sub-target also—18 per cent of the total lending must go to agriculture and 10 per cent of the total lending or 25 per cent of the priority sector lending (whichever be higher) must be lent out to the weaker sections. Other areas of the priority sector to be covered in the left amount i.e. 12 per cent of the total lending.

(ii) ***Foreign Banks*** have to fulfill only 32 per cent PSL target which has sub-targets for the exports (12 per cent) and small and medium enterprises (10 per cent). It means they need to disburse other areas of the PSL from the remaining 10 per cent of their total lending (***lesser burden***).

The Committee on Financial System (CFS, 1991) had suggested to immediately cut it down to 10 per cent for all banks and completely phasing out of this policy for the betterment of the banking industry in particular and the economy in general. The committee also suggested to shuffle the sectors covered under PSL every three years. No follow up has been done from the government except cutting down PSL target for the foreign banks from 40 per cent to 32 per cent. Meanwhile some new areas have been added to the PSL.

Revision in PSL

The Reserve Bank of India (RBI) panel on priority sector lending on 21st Feb. 2012 proposed that the target (priority sector) for foreign banks to be increased to 40 per cent of net bank credit from the current level of 32 per cent with sub-targets of 15 per cent for exports and 15 per cent for the Medium and Small Enterprises (MSE) sector, within which 7 per cent may be earmarked for micro enterprises. The target of domestic scheduled commercial banks for lending to the priority sector to be retained at 40 per cent of net bank credit. The ***Nair Committee,*** (under the Chairmanship of M. V. Nair, Chairman, Union Bank of India), has re-examined the existing classification and suggested revised guidelines with regard to priority sector lending and related issues. Major suggestions by the Committee are as given below:

(i) The committee suggested that the sector ***'agriculture and allied activities'*** may be a composite sector within the priority sector, by doing away with the distinction between *direct* and *indirect* agriculture. However, the targets for agriculture and allied activities would be at 18 per cent.

(ii) A *sub-target for* ***small*** and ***marginal farmers*** within agriculture and allied activities is recommended, equivalent to 9 per cent, which would be achieved in stages by 2015-16.

(iii) The ***MSE*** sector may continue to be under the priority sector. Within the MSE sector, a sub-target for micro enterprises is recommended, equivalent to 7 per cent, which would also be

achieved in stages by 2013-14.

(iv) The loans to ***housing*** sector may continue to be under the priority sector. Loans for construction or purchase of one dwelling unit per individual up to Rs.25 lakh; loans up to Rs.2 lakh in rural and semi urban areas and up to Rs.5 lakh in other centres for repair of damaged dwelling units may be granted under the priority sector.

(v) To encourage construction of dwelling units for economically weaker sections and low income groups, housing loans granted to these individuals may be included in the weaker sections category.

(vi) All loans to ***women*** under the priority sector may also be counted under loans to weaker sections.

(vii) The loans to ***education*** sector may continue to be under the priority sector. The limit under the priority sector for loans for studies in India may be increased to Rs.15 lakh and Rs.25 lakh in case of studies abroad, from the existing limit of Rs.10 lakh and Rs.20 lakh, respectively.

(viii) The Committee has also recommended allowing non-tradable priority sector lending certificates on a pilot basis with domestic scheduled commercial banks, foreign banks and regional rural banks as market players.

THE MENACE OF NPAS

Non-Performing Assets (NPAs) are bad debts of banks/Financial Institutions defined as follows w.e.f. March 31, 2001:[30]

An advance of banks/FIs where—

(i) interest and/or installment or principal remains overdue for a period more than 180 days in respect of a **term loan:**

(ii) interest and/or installment or principal remains overdue for two harvest seasons but for a period not exceeding two-and-a-half years in the case of **agricultural loans.** The NPAs were classified into three types:

   (a) Sub-standard: remaining NPAs for less than or equal to 18 months;

   (b) Doubtful : remaining NPAs for more than 18 months; and

   (c) Loss assets : where the loss has been identified by the bank or internal/external auditors or the RBI inspection but the amount has not been written off.

As per the All Indian Bank Employees Association (AIBEA), the premier union representing bank workers in India, the menace of NPAs has reached the following levels by March 31, 2001:[31]

- The NPAs of borrowers account owing more than ‘1 crore each to banks/FIs added to ` 80,574 crores
- if interests are also calculated it becomes over ` 1,50,000 crores.
- Nearly 80 per cent of it is owed to the PSBs (public sector banks).

New Steps to Check NPAs

As per the ***Economic Survey 2012-13***, though Indian banks remained well-capitalized, concerns regarding growing NPAs persisted – the present situation of the NPAs of the Indian banks is as given below:

- Overall NPAs of the banking sector increased from 2.36 per cent of total credit advanced in March 2011 to **3.57** per cent of total credit advanced in September 2012. While there has been an across-the-board increase in NPAs, the increase has been *particularly sharp* for the industry and infrastructure sectors, with NPAs as a percentage of credit advanced increasing from 1.91 per cent in March 2011 to 3.44 per cent as in September 2012. Sectors particularly under stress include textiles, chemicals, iron and steel, food processing, construction, and telecommunications.
- As per RBI data, gross NPAs *(GNPAs)* of PSBs (Public Sector Banks) have shown a rising trend during the last three years from Rs. 59,972 crore (March, 2010) to Rs. 1,44,437 crore (September, 2012). As a percentage of credit advanced, NPAs *(i.e Net NPAs)* were at a level of **4.01** per cent in September 2012 compared to 2.09 per cent in 2008-09.

The main ***reasons*** for increase in NPAs of banks are –

i. Switchover to system-based identification of NPAs by PSBs;
ii. Current macroeconomic situation in the country;
iii. Increased interest rates in the recent past;
iv. Lower economic growth; and
v. Aggressive lending by banks in the past, especially during good times.

Some recent ***initiatives*** taken by the government to address the rising NPAs include –

a. Appointment of nodal officers in banks for recovery at their head offices/ zonal offices/ for each Debts Recovery Tribunal (DRT);
b. Thrust on recovery of loss assets by banks;
c. Close watch on NPAs by picking up early warning signals and ensuring timely corrective steps by banks;
d. Directing the state-level Bankers' Committee to be proactive in resolving issues with the state governments; and
e. Designating asset reconstruction companies (ARCs) resolution agents of banks.

The ***RBI*** has also announced the following remedial measures –

a. Restructured standard account provisioning raised from the existing 2 per cent to 2.75 per pent;
b. The sanction of fresh loans/ad-hoc loans from 1st Jan 2013 will be made on the basis of sharing of information among banks;
c. Banks will conduct sector- /activity-wise analysis of NPAs;
d. Banks will put in place a robust mechanism for early detection of sign of distress, amendments in recovery laws, and strengthening of credit appraisal and post credit monitoring.

SARFAESI Act, 2002

GoI finally cracked down on the **wilful defaulters** by passing the *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002*.

The Act gives far reaching powers to the banks/FIs concering NPAs:

1. Banks/FIs having 75 per cent of the dues owed by the borrower can collectively proceed on the following in the event of the account becoming NPA:

(A) Issue notice of default to borrowers asking to clear dues within 60 days.

(B) On the borrower's failure to repay:

(i) Take possession of security and/or

(ii) take over the management of the borrowing concern and/or

(iii) appoint a person to manage the concern.

(C) If the case is already before the BIFR, the proceedings can be stalled if banks/FIs having 75 per cent share in the dues have taken any steps to recover the dues under the provisions of the ordinance.

2. The banks/FIs can also sell the security to a securitisation or Asset Reconstruction Company (ARC), estd. under the provisions of the Ordinance [The ARC is sought to be set up on the lines similar to the USA, few years ago.]

Debt Recovery Tribunals (DRTs)

Earlier, the Government had set up Debt Recovery Tribunals (DRTs) in 1993 which failed to bring about the desired change in the scenario due to[32] —

(i) DRTs are also clogged up with many cases and the judgement takes time (many months, if not years):

(ii) The sale of property can be made only through court appointed officials, adding delays;

(iii) The tribunals cannot take up the medium- or large-sized firms if they are under consideration of the BIFR due to sickness.

The praiseworthy step regarding recovery of the NPAs and allowing the setting up of the Asset Reconstruction Companies (ARCs) had an impact. Improved industrial climate and new options available to banks for dealing with bad loans helped in recovering a substantial amount of NPAs. The NPAs of scheduled commercial banks (SCBs) were at 2.3 per cent of total assets at end December 2011.[33]

CAPITAL ADEQUACY RATIO

At first sight bank is a business or industry a segment of the service sector in any economy. But the failure of a bank may have far greater damaging impact on an economy than any other kind of business or commercial activity. Basically, modern economies are heavily dependent on banks today than in the past—banks are today called the backbone of economies. Healthy functioning of banks is today essential for the proper functioning of an economy. As credit creation (***i.e. loan disbursals***) of banks are highly risky business, the depositors' money depends on the banks' quality of lending. More

importantly, the whole payment system, public as well as private, depends on banks. A bank's failure has the potential of creating chaos in an economy. This is why governments of the world pay special attention to the regulatory aspects of the banks. Every regulatory provision for banks tries to achieve a simple equation i.e. ***"how the banks should maximise their credit creation by minimising the risk and continue functioning permanently".*** In the banking business risks are always there and cannot be made 'zero'—as any loan forwarded to any individual or firm (irrespective of their credit-worthiness) has the risk of turning out to be a bad debt (***i.e. NPA in India***)—the probability of this being 50 per cent. But banks must function so that economies can function. Finally, the central banks of the world started devising tools to minimise the risks of banking at *one hand* and providing cushions (shock-absorbers) to the banks at the *other hand* so that banks do not go bust (i.e. shut down after becoming bankrupt). Providing cushion/shock-absorbers to banks has seen three major developments[34] :

(i) The provision of keeping a ***cash ratio*** of total deposits mobilised by the banks (known as the CRR in India);

(ii) The provision of maintaining some assets of the deposits mobilised by the banks with the banks themselves in ***non-cash form*** (known as the SLR in India); and

(iii) The provision of the capital adequacy ratio (CAR) norm.

The capital adequacy ratio (CAR) norm has been the last provision to emerge in the area of regulating the banks in such a way that they can sustain the probable risks and uncertainties of lending. It was in 1988 that the central banking bodies of the developed economies agreed upon such a provision, the CAR—also known as the **Basel Accord**[35]. The Accord was agreed upon at Basel, Switzerland at a meeting of the Bank for International Settlements (BIS).[36] It was at this time that the **Basel-I** norms of the capital adequacy ratio were agreed upon—a requirement was imposed upon the banks to maintain a certain amount of free capital (***i.e. ratio***) to their ***assets***[37] (i.e loans and investments by the banks) as a cushion against probable losses in investments and loans. In 1988, this ratio capital was decided to be 8 per cent. It means that if the total investments and loans forwarded by a bank amounts to ` 100, the bank needs to maintain a ***free capital*** [38] of ` 8 at that particular time. ***The capital adequacy ratio is the percentage of total capital to the total risk - weighted assets*** (see reference 39).

Capital Adequacy Ratio (CAR), a measure of a bank's capital, is expressed as a percentage of a bank's risk weighted credit exposures:

CAR= Total of the Tier 1 & Tier 2 capitals ÷ Risk Weighted Assets

Also known as 'Capital to Risk Weighted Assets Ratio (CRAR)' this ratio is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital were measured as per the **Basel II** norms – *Tier 1* capital, which can absorb losses without a bank being required to cease trading, and *Tier 2* capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. The new norms (**Basel III**) has devised a third category of capital- *Tier 3* capital.

The RBI introduced the ***capital-to-risk weighted assets ratio*** (CRAR) system for the banks operating in India in 1992 in accordance with the standards of the BIS—as part of the financial sector reforms.[39] In the coming years the Basel norms were extended to term-lending institutions, primary dealers and non-banking financial companies (NBFCs), too. Meanwhile the BIS came up with another

set of the CAR norms, popularly known as **Basel-II.** The RBI guidelines regarding the CAR norms in India have been as given below:

1. **Basel-I** norm of the CAR was to be achieved by the Indian banks by March 1997.
2. The CAR norm was raised to 9 per cent with effect from March 31, 2000 (*Narasimham Committee-II had recommended to raise it to 10 per cent in 1998*).[40]
3. Foreign banks as well as Indian banks with foreign presence to follow ***Basel-II norms*** w.e.f. March 31, 2008 while other scheduled commercial banks to follow it not later than March 31, 2009. The Basel-II norm for the CAR is 12 per cent.[41]

WHY TO MAINTAIN CAR?

The basic question which comes to mind is as to why do the banks need to hold capital in the form of CAR norms? ***Two*** **reasons**[42] have been generally forwarded for the same:

(i) Bank capital helps to prevent bank failure, which arises in case the bank cannot satisfy its obligations to pay the depositors and other creditors. The low capital bank has a negative net worth after the loss in its business. In other words, it turns into insolvent capital, therefore, acts as a cushion to lessen the chance of the bank turning insolvent.

(ii) The amount of capital affects returns for the owners (equity holders) of the bank.

Basel Accords

The Basel Accords (i.e. Basel I, II and now Basel III) are a set of agreements set by the Basel Committee on Bank Supervision (BCBS), which provides recommendations on banking regulations in regards to capital risk, market risk and operational risk. The purpose of the accords is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. They are of paramount importance to the banking world and are presently implemented by over 100 countries across the world. The BIS Accords were the outcome of a long-drawn-out initiative to strive for greater international uniformity in prudential capital standards for banks' credit risk. The objectives of the accords could be summed up[43] as:

(i) to strengthen the international banking system;

(ii) to promote convergence of national capital standards; and

(iii) to iron out competitive inequalities among banks across countries of the world.

The Basel Capital Adequacy Risk-related Ratio Agreement of 1988 (**i.e. Basel I**) was not a legal document. It was designed to apply to internationally active banks of member countries of the Basel Committee on Banking Supervision (BCBS) of the BIS at Basel, Switzerland. But the details of its implementation were left to national discretion. This is why Basel I looked G10-centric.[44]

The first Basel Accord, known as **Basel I**, was issued in 1988 and focuses on the capital adequacy of financial institutions. The capital adequacy risk (the risk a financial institution faces due to an unexpected loss), categorizes the assets of financial institution into five risk categories (0%, 10%, 20%, 50%, 100%). Banks that operate internationally are required to have a risk weight of 8% or

less.

The second Basel Accord, known as **Basel II**, is to be fully implemented by 2015. It focuses on three main areas, including minimum capital requirements, supervisory review and market discipline, which are known as the *three pillars*. The focus of this accord is to strengthen international banking requirements as well as to supervise and enforce these requirements.

The third Basel Accord, known as **Basel III** is a comprehensive set of reform measures aimed to strengthen the regulation, supervision and risk management of the banking sector. These measures aim[45] to:

(i) improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source

(ii) improve risk management and governance

(iii) strengthen banks' transparency and disclosures.

The capital of the banks has been classified into ***three tiers*** as given below:

Tier 1 Capital: A term used to describe the capital adequacy of a bank – it can absorb losses without a bank being required to cease trading. This is the **core measure** of a bank's financial strength from a regulator's point of view (this is the *most reliable* form of capital). It consists of the types of financial capital considered the most reliable and liquid, primarily stockholders' equity and disclosed reserves of the bank- equity capital can't be redeemed at the option of the holder and disclosed reserves are the liquid assets available with the bank itself.

Tier 2 Capital: A term used to describe the capital adequacy of a bank – it can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. Tier II capital is secondary bank capital (the *second most reliable* forms of capital). This is related to Tier 1 Capital. This capital is a measure of a bank's financial strength from a regulator's point of view. It consists of accumulated after-tax surplus of retained earnings, revaluation reserves of fixed assets and long-term holdings of equity securities, general loan-loss reserves, hybrid (debt/equity) capital instruments, and subordinated debt and undisclosed reserves.

Tier 3 Capital: A term used to describe the capital adequacy of a bank – considered the *tertiary capital* of the banks which are used to meet/support market risk, commodities risk and foreign currency risk. It includes a variety of debt other than Tier 1 and Tier 2 capitals. Tier 3 capital debts may include a greater number of subordinated issues, undisclosed reserves and general loss reserves compared to Tier 2 capital. To qualify as Tier 3 capital, assets must be limited to 250 per cent of a bank's Tier 1 capital, be unsecured, subordinated and have a minimum maturity of two years.

Disclosed Reserves are the total liquid cash and the SLR assets and of the banks that may be used any time. This way they are part of its *core capital* (Tier 1). *Undisclosed Reserves* are the unpublished or hidden reserves of a financial institution that may not appear on publicly available documents such as a balance sheet, but are nonetheless real assets, which are accepted as such by most banking institutions but cannot be used at will of the bank. That is why they are part of its *secondary capital* (Tier 2).

Basel III Provisions[46]

The new provisions have defined the capital of the banks in different way – they consider common

equity and retained earnings as the predominant component of capital (as the past) but they restrict inclusion of items such as deferred tax assets, mortgage-servicing rights and investments in financial institutions to no more than 15% of the common equity component. These rules aim to improve the *quantity* and *quality* of the capital.

While the key capital ratio has been raised to 7% of risky assets, according to the new norms, Tier-I capital that includes common equity and perpetual preferred stock will be raised from 2 to 4.5% starting in phases from January 2013 to be completed by January 2015. In addition, banks will have to set aside another 2.5% as a *contingency* for future stress. Banks that fail to meet the buffer would be unable to pay dividends, though they will not be forced to raise cash.

The new norms are based on renewed focus of central bankers on 'macro-prudential stability'. The global financial crisis following the crisis in the US sub-prime market has prompted this change in approach. The previous set of guidelines, popularly known as *Basel II* focused on 'macro-prudential regulation'. In other words, global regulators are now focusing on financial stability of the system as a whole rather than micro regulation of any individual bank.

Banks in the West, which are market leaders for the most part, face low growth, an erosion in capital due to sovereign debt exposures and stiffer regulation – they will have to reckon with a permanent decline in their returns on equity thanks to enhanced capital requirements under the new norms. In contrast, Indian banks - and those in other emerging markets such as China and Brazil – are well-placed to maintain their returns on capital consequent to Basel III. The financial experts have opined that Basel III looks changing the economic landscape in which banking power shifts towards the emerging markets.

Preparing PSBs for Basel III Capital Compliance

As capital is a key measure of banks' capacity for generating loan assets and is essential for balance sheet expansion, the Government of India (GoI) has regularly invested additional capital in the PSBs to support their growth and keep them financially sound so as to ensure that the growing credit needs of the economy are adequately met. A sum of Rs. 12,000 crore was infused in seven PSBs during 2011-12 to enable them to maintain a minimum Tier-I CRAR of 8 per cent and also to increase shareholding of the GoI in them.

In 2012-13 also, the Government has infused capital in PSBs to augment their Tier-I capital so that they maintain their Tier-I CRAR at a comfortable level and remain compliant with the stricter capital adequacy norms[47] under Basel III. This will also support internationally active PSBs in their national and international banking operations undertaken through their subsidiaries and associates. An amount of Rs. 12, 517 crore was allocated by the GoI for the year 2012-13 on January 10, 2013.

The **High Level Committee** to assess the capitalization of PSBs in the next 10 years, headed by the Finance Secretary has recommended various options for funding of PSBs. Given the budgetary constraints, it may not be feasible for the government to infuse huge sums into the PSBs. This is why the Committee has recommended the formation of a *'non-operating financial holding company' **(HoldCo)*** under a special *act of Parliament* with the following key objectives –

i. To act as an investment company for the GoI;

ii. To hold a major portion of the GoI's holdings in all PSBs;

iii. To raise long-term debt from domestic and international markets to infuse equity into PSBs; and

iv. To service the debt from within its sources.

Due to weakening of the RRBs also their sponsor banks have been incurring huge NPAs. RRBs have played a pivotal role in credit delivery in rural areas, particularly to the agriculture sector – to enhance their outreach and provide banking services more effectively to rural masses, RRBs need to undertake a continuous process of technology and capital upgradation. With a view to bringing the CRAR of RRBs up to at least 9 per cent, **Dr K C Chakrabarty Committee** recommended recapitalisation support to the extent of Rs. 2,200 crore to 40 RRBs in 21 States. Pursuant to the recommendation of the Committee, recapitalization amount is to be shared by the stakeholders in proportion to their shareholding in RRBs, i.e. 50 per cent central government, 15 per cent concerned state government, and 35 per cent the concerned sponsor banks. The re-capitalisation will continue upto March 2014.

Stock of Money

In every economy it is necessary for the central bank to know the stock (amount/level) of money available in the economy only then it can go for suitable kind of credit and monetary policy. Saying simply, credit and monetary policy of an economy is all about changing the level of money flowing in the economic system. But it can be done only when we know the real flow of money. That's why it is necessary to first assess the level of money flowing in the economy.

Following the recommendations of the *Second Working Group on Money Supply (SWG)* in 1977, RBI has been publishing four *monetary aggregates* (component of money)– M_1, M_2, M_3 and M_4 (are basically short terms for the Money-1, Money-2, Money-3 and Money-4) besides the Reserve Money. These components used to contain money of differing liquidities:

M_1 = Currency & coins with people + Demand deposits of Banks (Current & Saving Accounts) + Other deposits of the RBI.

M_2 = M_1+ Demand deposits of the post offices (i.e. saving schemes' money).

M_3 = M_1+ Time/Term deposits of the Banks (i.e. the money lying in the Recurring Deposits & the Fixed Deposits).

M_4 = M_3+ total deposits of the post offices (both, Demand and Term/Time Deposits).

Now the RBI has started[48] publishing a set of new monetary aggregates following the recommendations of the *Working Group on Money Supply: Analytics and Methodology of Compilation* (Chairman: Dr. Y.V. Reddy) which submitted its report in June 1998. The Working Group recommended compilation of four monetary aggregates on the basis of the balance sheet of the banking sector in conformity with the norms of progressive liquidity: M_0 (monetary base), M_1 (narrow money), M_2 and M_3 (broad money). In addition to the monetary aggregates, the Working Group had recommended compilation of three liquidity aggregates namely, L_1, L_2 and L_3, which include select items of financial liabilities of non-depository financial corporations such as development financial institutions and non-banking financial companies accepting deposits from the public, apart from post office savings banks. The **New Monetary Aggregates** are as given below:

Reserve Money (M_0) = Currency in Circulation + Bankers' deposits with the RBI + 'Other'[49] deposits with the RBI.

Narrow Money (M_1) = Currency with the Public + Demand Deposits with the Banking System + 'Other' Deposits with the RBI.

M_2=M_1 + Savings Deposits of Post-office Savings Banks.

Broad Money (M_3) = M_1 + Time Deposits with the Banking System.

M_4 = M_3 + All deposits with Post Office Savings Banks (excluding National Savings Certificates).

While the Working Group did not recommend any change in the definition of reserve money and M_1, it proposed a new *intermediate monetary aggregate* to be referred to as **NM_2** comprising currency and residents' short-term bank deposits with contractual maturity up to and including one year, which would stand in between narrow money (which includes only the non-interest-bearing monetary liabilities of the banking sector) and broad money (an all-encompassing measure that includes long-term time deposits). The new broad money aggregate (referred to as **NM_3** for the purpose of clarity) in the Monetary Survey would comprise in addition to NM_2, long-term deposits of residents as well as call/term borrowings from non-bank sources, which have emerged as an important source of resource mobilisation for banks. The critical *difference* between M_3 and NM_3 is the treatment of non-resident repatriable fixed foreign currency liabilities of the banking system in the money supply compilation.

There are **two basic changes** in the new monetary aggregates. *First,* since the post office bank is not a part of the banking sector, ***postal deposits*** are no longer treated as part of money supply, as was the case in the extant M_2 and M_4. *Second,* the residency criterion was adopted to a limited extent for compilation of monetary aggregates. The Working Group made a recommendation in favour of compilation of monetary aggregates on residency basis. Residency essentially relates to the country in which the holder has a centre of economic interest. Holdings of currency and deposits by the non-residents in the rest of the world sector, would be determined by their portfolio choice. However, these transactions form part of balance of payments (BoP). Such holdings of currency and deposits are not strictly related to the domestic demand for monetary assets. It is therefore argued that these transactions should be regarded as external liabilities to be netted from foreign currency assets of the banking system. However, in the context of developing countries such as India, which have a large number of expatriate workers who remit their savings in the form of deposits, it could be argued that these non-residents have a centre of economic interest in their country of origin. Although in a macro-economic accounting framework all non-resident deposits need to be separated from domestic deposits and treated as capital flows, the underlying economic reality may point otherwise. In the Indian context, it may not be appropriate to exclude all categories of non-resident deposits from domestic monetary aggregates as non-resident rupee deposits are essentially integrated into the domestic financial system. The new monetary aggregates, therefore, exclude only non-resident repatriable foreign currency fixed deposits from deposit liabilities and treat those as external liabilities. Accordingly, from among the various categories of non-resident deposits at present, only Foreign Currency Non-Resident Accounts (Banks) [FCNR(B)] deposits are classified as external liabilities and excluded from the domestic money stock. Since the bulk of the FCNR(B) deposits are

held abroad by commercial banks, the monetary impact of changes in such deposits is captured through changes in net foreign exchange assets of the commercial banks. Thus, now the new monetary aggregates NM_2 and NM_3 as well as liquidity aggregates L_1, L_2, and L3 have been introduced, the components of which are elaborated as follows:

NM_1 = Currency with the Public + Demand Deposits with the Banking System + 'Other' Deposits with the RBI.

NM_2 = NM_1 + Short Term Time Deposits of Residents (including and up to the contractual maturity of one year).

NM_3= NM_2 + Long-term Time Deposits of Residents + Call/Term Funding from Financial Institutions.

L_1 = NM_3 + All Deposits with the Post Office Savings Banks (excluding National Savings Certificates)

L_2 = L_1 +Term deposits with Term Lending Institutions and Refinancing Institutions (FIs) + Term Borrowing by FIs + Certificates of Deposit issued by FIs

L_3 = L_2 + Public Deposits of Non-banking Financial Companies.

Data on M_0 are published by the RBI on *weekly* basis, while those for M_1 and M_3 are available on *fortnightly* basis. Among liquidity aggregates, data on L_1 and L_2 are published *monthly,* while those for L_3 are disseminated *quarterly*. The working group advised for the quarterly publication of **Financial Sector Survey** to capture the dynamic linkages between banks and rest of the organised financial sector.

Liquidity of Money

As we move from M_1 to M_4 the liquidity (inertia, stability, spendability) of the money goes on decreasing and in the opposite direction, the liquidity increases.

Narrow Money

In banking terminology, M_1 is called narrow money as it is highly liquid and banks cannot run their lending programmes with this money.

Broad Money

The money component M_3 is called broad money in the banking terminology. with this money (which lies with banks for a known period) banks run their lending programmes.

Money Supply

In general discussion we usually use money supply to mean money circulation, money flow in the economy. But in banking and typical monetary management terminology the level and supply of M_3 is known as money supply. The growth rate of broad money (M_3) i.e. *money supply*, was not only lower

than the indicative growth set by the Reserve Bank of India but also it witnessed continuous and sequential deceleration in the last 7 quarters and moderated to 11.2 per cent by December, 2012. Aggregate deposits with the banks were the major component of broad money counting for over 85 per cent remaining almost stable. The sources of broad money are net bank credit to the Government and to the commercial sector. These two together accounted for nearly 100 per cent of the broad money in 2012-13 compared to 89 percent in 2009-10.

Minimum Reserve

The RBI is required to maintain a reserve equivalent of Rs. 200 crores in gold and foreign currency with itself, of which Rs. 115 crores should be in gold. This is being followed since 1957 and is known as the Minimum Reserve System (MRS).

Reserve Money

The gross amount of the following six segments of money at any point of time is known as the Reserve Money (RM) for the economy or the government:

1. RBI's net credit to the Government;
2. RBI's net credit to the Banks;
3. RBI's net credit to the commercial banks;
4. Net forex reserve with the RBI;
5. Government's currency liabilities to the Public;
6. Net non-monetary liabilities of the RBI.

RM = 1 + 2 + 3 + 4 + 5 + 6

As per the *Economic Survey 2012-13,* the rate of growth of reserve money comprising currency in circulation and deposits with RBI (bankers and others) decelerated from an average of 17.6 per cent in Q1 of 2011-12 to 4.3% in Q3 of 2012-13. Almost the entire increase in the reserve money of Rs. 2381 billion between Q3 of 2011-12 and Q3 of 2012-13 consisted of increase in *currency in circulation*. As sources of reserve money, net RBI credit to Government and increase in net financial assets of RBI contributed to the growth of *base money*.

Money Multiplier

At end March 2012, the *money multiplier* (ratio of M_3 to M_0) was 5.2, higher than end-March 2011, due to cumulative 125 basis point reduction in CRR. During 2012-13, the money multiplier generally stayed high reflecting again, the CRR cuts. As on **December 28, 2012**, the money multiplier was 5.5 compared with 5.2 on the corresponding date of the previous year *(Economic Survey 2012-13)*.

Credit Counselling

Advising borrowers to overcome their debt burden and improve money management skills is credit counselling. The first well-known such agency was created in the USA when credit granters created National Foundation for Credit Counselling (NFCC) in 1951.[50]

India’s sovereign debt is usually rated by six major sovereign credit rating agencies (SCRAs) of the world which are –

i. Fitch Ratings,
ii. Moody’s Investors Service,
iii. Standard and Poor’s (S&P),
iv. Dominion Bond Rating Service (DBRS),
v. Japanese Credit Rating Agency (JCRA), and
vi. Rating and Investment Information Inc., Tokyo (R&I).

As on *January 15, 2013* most of these rating agencies have put India under ‘stable’ category in foreign and local currencies barring Fitch and S&P which have put its foreign currency in ‘negative’ category. The government is taking a number of steps to improve its interaction with the major SCRAs so that they make informed decisions as the *Economic Survey 2012-13* says.

Credit Rating

To assess the credit worthiness (credit record, integrity, capability) of a prospective (would be) borrower to meet debt obligations is credit rating. Today it is done in the cases of individuals, companies and even countries. There are some world-renowned agencies such as the Moody’s, S & P. The concept was first introduced by **John Moody** in the USA (1909). Usually equity share is not rated here. Primarily, ratings are an investor service.

Credit rating was introduced in India is 1988 by the ICICI and UTI, jointly. The major credit rating agencies of India are-

(i) *CRISIL* (Credit Rating Information of India Ltd.) was jointly **promoted** by ICICI and UTI with share capital coming from SBI, LIC, United India Insurance Company Ltd. to rate debt instrument—**debenture**. In April 2005 its 51 per cent equity was acquired by the US credit rating agency Standard & Poor (S & P)—a McGraw Hill Group of Companies.

(ii) *ICRA* (Investment Information and Credit Rating Agency of India Ltd.) was set up in 1991 by IFCI, LIC, SBI and select banks as well as financial institutions to rate debt instruments.

(iii) *CARE* (Credit Analyses and Research Ltd.) was set up in 1993 by IDBI, other financial institutions, nationalised banks and private sector finance companies to rate all types of debt instruments.

(iv) *ONICRA* (Onida Individual Credit Rating Agency of India Ltd.) was set up by ONIDA Finance (a private sector finance company) in 1995 to rate credit-worthiness of non-corporate consumers and their debt instruments i.e. credit cards, hire-purchase, housing finance, rental agreements and bank finance.

(v) *SMERA* (Small and Medium Enterprises Rating Agency) was set up in September 2005, to rate the overall strength of small and medium enterprises (SMEs)—the erstwhile SSIs. It is not a credit rating agency precisely but its ratings are used for this purpose, too. A joint venture of SIDBI (the largest share-holder with 22 per cent stake), SBI, ICICI Bank, Dun & Bradstreet (an international credit information company), five public sector banks (PNB, BOB, BOI, Canara Bank, UBI with 28 per cent stake together) and CIBIL (Credit Information

Bureau of India Ltd.).

A general credit rating service not linked to any debt issue is also availed by companies—already offered in India by rating agencies—CRISIL calls such ratings as **Credit Assessment.**[51] International rating agencies such as Moody's, S & P also undertake sovereign ratings i.e. of countries—highly instrumental in external borrowings of the countries.

Individuals are also covered by credit appraisal which is on useful information for the consumer credit firms. To maintain a database on the credit records of individuals the Credit Information Bureau of India Limited (CIBIL) was set up in May 2004 which makes credit informations available to banks and financial institutions about prospective individual borrowers.[52]

NON-RESIDENT INDIAN DEPOSITS

Foreign Exchange Management (Deposit) Regulations, 2000 permits Non-Resident Indians (NRIs) to have deposit accounts with authorised dealers and with banks authorised by the Reserve Bank of India (RBI) which include[53] :

1. Foreign Currency Non-Resident (Bank) Account [FCNR(B) Account]
2. Non-Resident External account (NRE Account)
3. Non-Resident Ordinary Rupee account (NRO Account)

FCNR(B) accounts can be opened by NRIs and Overseas Corporate Bodies (OCBs) with an authorised dealer. The accounts can be opened in the form of term deposits. Deposits of funds are allowed in Pound Sterling, US Dollar, Japanese Yen and Euro. Rate of interest applicable to these accounts are in accordance with the directives issued by RBI from time to time.

NRE accounts can be opened by NRIs and OCBs with authorised dealers and with banks authorised by RBI. These can be in the form of savings, current, recurring or fixed deposit accounts. Deposits are allowed in any permitted currency. Rate of interest applicable to these accounts are in accordance with the directives issued by RBI from time to time.

NRO accounts can be opened by any person resident outside India with an authorised dealer or an authorised bank for collecting their funds from local bonafide transactions in Indian Rupees. When a resident becomes an NRI, his existing Rupee accounts are designated as NRO. These accounts can be in the form of current, savings, recurring or fixed deposit accounts.

There were two more NRI deposit accounts in operation, viz. *Non-Resident (Non-Repatriable) Rupee Deposit Account* and *Non-Resident (Special) Rupee Account* – an amendment to Foreign Exchange Management (Deposit) Regulations, in 2002, discontinued the acceptance of deposits in these two accounts from April 2002 onwards.

Repatriation of funds in FCNR(B) and NRE accounts is permitted. Hence, deposits in these accounts are included in India's *external debt* outstanding. While the principal of NRO deposits is non-repatriable, current income and interest earning is repatriable. Account-holders of NRO accounts are permitted to annually remit an amount up to US$ 1 million out of the balances held in their accounts. Therefore, deposits in NRO accounts too are included in India's *external debt.*

Guidelines for Licensing of New Banks

The RBI on *February 22, 2013* released the Guidelines for *'Licensing of New Banks in the Private Sector'*. Key features of the guidelines are:

1. *Eligible Promoters:* A private sector/public sector/Non-Banking Financial Companies (NBFCs) entity/group eligible to set up a bank through a wholly-owned "Non-Operative Financial Holding Company (NOFHC)".
2. *'Fit and Proper' criteria:* A past record of sound credentials, integrity and sound financial background with a successful track record of 10 years will be required.
3. *Corporate structure of the NOFHC:* The NOFHC to be wholly owned by the Promoter/Promoter Group which shall hold the bank as well as all the other financial services entities of the group.
4. *Minimum voting equity capital requirements for banks and shareholding by NOFHC:* The initial minimum *paid-up voting equity capital*[54] for a bank shall be Rs. 5 billion. The NOFHC shall initially hold a minimum of 40 per cent of the paid-up voting equity capital of the bank which shall be locked in for a period of *five years* and which shall be brought down to 15 per cent within 12 years. Bank's shares to be listed on the stock exchanges within *three years* of the business commencement.
5. *Regulatory framework:* The bank to be regulated by the relevant Acts/Statutes/Directives, issued by RBI and other regulators. The NOFHC shall be *registered as* a non-banking finance company (NBFC) with the RBI and will be governed by a separate set of directions issued by RBI.
6. *Foreign shareholding in the bank:* Foreign shareholding upto 49% for the first 5 years after which it will be as per the extant policy.
7. *Corporate governance of NOFHC:* At least 50 per cent of the Directors of the NOFHC should be independent directors. The corporate structure should not impede effective supervision of the bank and the NOFHC by RBI.
8. *Prudential norms for the NOFHC:* The *prudential norms* will be applied to NOFHC on similar lines as that of the bank.
9. *Exposure norms:* The Bank/NOFHC allowed no *exposure* to the Promoter Group – the bank shall not invest in the equity/debt capital instruments of any financial entities held by the NOFHC.
10. *Business Plan for the bank:* The business plan should be realistic and viable and should address how the bank proposes to achieve *financial inclusion*.
11. *Additional conditions for NBFCs promoting/converting into a bank :* Existing NBFCs, if considered eligible, may be permitted to promote a new bank or convert themselves into banks.
12. *Other conditions for the bank :*
    a. To open at least 25 per cent of its branches in unbanked rural centres (population upto 9,999 as per the latest census).
    b. To comply with the *priority sector lending* targets applicable to the existing domestic

banks.

d. Banks promoted by groups having 40 per cent or more assets/income from non-financial business will require RBI's prior approval for raising paid-up voting equity capital beyond Rs. 10 billion.

e. Any non-compliance of terms and conditions will attract penal measures including cancellation of licence of the bank.

Non-Operative Financial Holding Company (NOFHC) [55]

The difference between an *operating company* and a *holding company* lies in the fundamental structures of the two, in their management and their interactions with one another. Business goals are often different, and both business types are after profits, but holding companies can still benefit from operating company losses under certain conditions.

The primary function of a ***holding company*** is to invest in other companies, commonly known as subsidiaries. Holding companies are usually not involved in day-to-day operations of the operating company, but lend initial or ongoing financial support via cash reserves or stock sales, and may assist in restructuring the operational model to ensure profits. Holding companies are normally structured as *corporations* (limited liability firms i.e. known as a **Ltd.** company in India) to protect assets and absorb financial losses.

Operating companies are owned by the holding company, but are responsible for all day-to-day operations of the company. When a holding company creates or purchases an operating company, they are sometimes allowed to conduct business as usual – especially, if they are profitable. Net profits after expenses are then handed over to the holding company.

Ownership of operating companies, even when purchased, revert to the holding company. Former owners who are kept on-board are often given control of the operating company in the form of executive management responsibility, but have no ownership rights. All major decisions that may affect profitability or involve large expenditures must first be approved by the holding company.

Although operating company *profitability* should make sense for the holding company, this is not always the case. Especially for larger holding companies with heavy tax burdens, owning one or more operating companies that lose money can benefit the parent company in the form of a business loss when tax time rolls around. This does not benefit the operating company, as it is responsible for operating income to run the business. If the losses become too great, operating companies can go out of business, but the holding company can still benefit because the operating company can help to balance overall profits and stock prices.

There are *three basic types* of holding companies –

i. A *pure holding company* that is non-operating and exists solely to invest in and hold the voting shares of its subsidiaries. This type of holding company derives its income from the dividends earned from its ownership of the shares of its subsidiaries and from any gains realised from other investments.

ii. A *general* or *operating holding company* that earns its income from selling goods and services in addition to the income derived from its ownership of subsidiaries.

iii. A *pyramid holding company* that owns controlling interest in its subsidiaries with less

invested capital than the two other categories.

Nidhi

Nidhi in the Indian context 'treasure'. However, in the Indian financial sector it refers to any *mutual benefit society*[56] notified by the Central / Union Government as a Nidhi Company. They are created mainly for cultivating the habit of *thrift* and *savings* amongst its members. The companies doing Nidhi business, viz. borrowing from members and lending to members only, are known under different names such as *Nidhi, Permanent Fund, Benefit Funds, Mutual Benefit Funds* and *Mutual Benefit Company.*

Nidhis are more popular in ***South India*** and are highly localized single office institutions. They are mutual benefit societies, because their dealings are restricted only to the members; and membership is limited to individuals. The principal source of funds is the contribution from the members. The loans are given to the members at relatively reasonable rates for purposes such as house construction or repairs and are generally secured. The deposits mobilized by Nidhis are not much when compared to the organized banking sector.

Nidhis are companies registered under the Companies Act, 1956 and are regulated by Ministry of Corporate Affairs (MCA). Even though Nidhis are regulated by the provisions of the Companies Act, 1956, they are exempted from certain provisions of the Act, as applicable to other companies, due to limiting their operations within members.

Nidhis are also included in the definition of Non- Banking Financial companies or ***(NBFCs)*** which operate mainly in the *unorganized money market*. However, since 1997, NBFCs have been brought increasingly under the regulatory ambit of the RBI. Non-banking financial entities partially or wholly regulated by the RBI include:

i. NBFCs comprising equipment leasing (EL), hire purchase finance (HP), loan (LC), investment (IC) [including primary dealers (PDs)] and residuary non-banking (RNBC) companies;
ii. Mutual benefit financial company (MBFC), i.e. *nidhi company*;
iii. Mutual benefit company (MBC), i.e. potential nidhi company; i.e., a company which is working on the lines of a Nidhi company but has not yet been so declared by the Central Government; has minimum net owned fund (NOF) of Rs.10 lakh, has applied to the RBI for certificate of registration and also to Department of Company Affairs (DCA) for being notified as Nidhi company and has not contravened directions / regulations of RBI/DCA.
iv. Miscellaneous non-banking company (MNBC), i.e. *chit fund company*.

Since Nidhis come under one class of NBFCs, RBI is empowered to issue directions to them in matters relating to their deposit acceptance activities. However, in recognition of the fact that these Nidhis deal with their shareholder-members only, RBI has exempted the notified Nidhis from the core provisions of the RBI Act and other directions applicable to NBFCs. As on date *(February 2013)* RBI does not have any specified regulatory framework for Nidhis.

The Central Government in March 2000 constituted a Committee to examine the various aspects of the functioning of Nidhi Companies. There was no Government Notification defining the word 'Nidhi'. Taking into consideration the manner of functioning of Nidhis and the recommendations of the *P.*

Sabanayagam Committee in its report and also to prevent unscrupulous persons using the word 'Nidhi' in their name without being incorporated by Department of Company Affairs (DCA) and yet doing Nidhi business, the Committee suggested the following ***definition*** for Nidhis (a part of this definition is appearing in the new *Companies Bill 2012 (Section 406):*

"Nidhi is a company formed with the exclusive object of cultivating the habit of thrift, savings and functioning for the mutual benefit of members by receiving deposits only from individuals enrolled as members and by lending only to individuals, also enrolled as members, and which functions as per Notification and Guidelines prescribed by the DCA. The word Nidhi shall not form part of the name of any company, firm or individual engaged in borrowing and lending money without incorporation by DCA and such contravention will attract penal action."

Chit Fund

Recently, Chit Fund was in centre of news after the Kolkata-based *Saradha Chit Fund* scam came to light. Most of the media people were themselves not very clear about the 'finer' points related to the idea of 'chits' in India – but they kept on highlighting chits as they needed to report on the scam! Let us try understanding the Chits and some other similar concepts in India:

Chit funds (also known by their other names such as – *Chitty, Kuri, Miscellaneous Non-Banking Company*) are essentially saving institutions. They are of various forms and lack any standardised form. Chit funds have regular members who make periodical subscriptions to the fund. The periodic collection is given to some member of the chit funds selected on the basis of previously agreed criterion. The beneficiary is selected usually on the basis of bids or by draw of lots or in some cases by auction or by tender. In any case, each member of the chit fund is assured of his turn before the second round starts and any member becomes entitled to get periodic collection again. Chit funds are the Indian versions of 'Rotating Savings and Credit Associations' found across the globe.

Chit fund business is regulated under the Central Act of *Chit Funds Act, 1982* and the Rules framed under this Act by the various State Governments for this purpose. Central Government has not framed any Rules of operation for them. Thus, Registration and Regulation of Chit funds are carried out by *State Governments* under the Rules framed by them. Functionally, Chit funds are included in the definition of Non- Banking Financial Companies by RBI under the sub-head *miscellaneous non-banking company*(MNBC). But RBI has not laid out any separate regulatory framework for them.

Official Definition: As per the Chit Funds Act 1982, chit means "a transaction whether called *chit, chit fund, chitty, kuri* or by *any other name* by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of *grain* instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount". A transaction is not a chit, if in such transaction –

i. Some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or
ii. All the subscribers get the chit amount by turns with a liability to pay future subscriptions.

1. The discussion here is based on the updated informations released by the ***RBI,*** May 11, 2012.
2. Based on the ***RBI Nationalisation Act, 1949*** and further announcements of the Government of India (MoF).
3. ***RBI Act, 1934,*** sub-section (1) of Section 42.
4. ***Annual Policy Statement 2010–11,*** RBI***,*** April 20, 2010, N. Delhi & *RBI* dated 17th March 2011.
5. ***Economic Survey, 2006–07,*** MoF, GoI, N. Delhi.
6. ***RBI (Amendment) Act,*** 2006, GoI, N. Delhi.
7. ***Credit and Monetary Policy,*** April 1, 2007, op. cit.
8. ***RBI Act, 1934*** and ***Banking Regulation Act, 1949*** Section 24.
9. ***Committee on Financial System*** (CFS) headed by the then RBI Deputy Governor M. Narasimhan, 1991.
10. Through an RBI announcement on 15th Feb. 2012.
11. Ibid
12. Stiglitz and Walsh, ***Economics,*** op. cit., p. 629–630.
13. ***Economic Survey 2001–02,*** MoF, GoI, N. Delhi.
14. The write-up is based on – the *RBI's Credit & Monetary Policy, 2011-12* (in which the Scheme was introduced); and the *European Central Bank*, Frankfurt, Germany and *Federal Reserve System* (also known as the *Federal Reserve*, and informally as the *Fed*) Washington, DC, USA
15. ***RBI Announcement,*** RBI, MoF, GoI, New Delhi, Feb. 15, 2012.
16. ***RBI Announcement,*** RBI, MoF, GoI, New Delhi, Apr.5, 2010.
17. As per the ***Strategic Disinvestment Statement of 1999,*** the Government had decided to cut its holding in them to 26 percent. The policy was put on hold once the UPA Government came to power.
18. Y.V. Reddy, ***Lectures on Economic and Financial Sector Reforms in India,*** Oxford U. Press, N. Delhi, 2002, pp. 137–57.
19. Repeated by the GoI many times i.e. the ***New Industrial Policy 1991; the Union Budget 1992–93; Eighth Five Year Plan (1992–97) Draft Approach;*** etc.
20. Announced by the Government while setting up the M. Narasimham ***Committee on Finacial System*** on August 14, 1991. See also ***India 2001,*** Pub. Div., GoI, N. Delhi.
21. The Narasimham Committee handed over its report in record time within 3 months after it was set up.
22. ***CFS,*** op. cit.
23. Ibid.
24. Based on Y.V. Reddy, 2002, op. cit.
25. ***Economic Survey 1998–99,*** MoF, GoI, N. Delhi.
26. Based on the Report of the ***Committee on Banking Sector Reforms,*** April, 1998 (Chairman: M. Narasimham).
27. An integrated system of regulation and supervision was suggested by the Committee so that soundness of the financial system could be ensured—the concept of a financial ***super-regulator*** gets vindicated, as opines Y. V. Reddy, 2002, op. cited, p. 38.
28. ***India 2007,*** Pub. Div., GoI, N. Delhi and the further announcements by the RBI.
29. The change was effected from May 20, 2007 as per the RBI announcement.
30. ***Economic Survey 2001–02.*** MoF, GoI, N. Delhi.
31. Ibid.
32. ***Economic Survey 2001-02*** & ***India 2002,*** Pub. Div., GoI, N. Delhi.
33. ***Economic Survey 2011–12,*** MoF, GoI, N. Delhi.
34. Through various legislations since the ***RBI Nationalisation Act, 1949*** and the ***Banking Regulation Act, 1949*** were enacted – and further ***Amendments*** to the Acts, MoF, GoI, New Delhi.
35. Simon Cox (ed.), ***Economics,*** The Economist, 2007, op. cit., p. 145.
36. The ***BIS*** is today a central bank for central bankers set up in 1930 in a round tower near Basel railway station in Switzerland as a private company owned by a number of central banks, one commercial bank (Citibank) and some private individuals. Today it functions as a meeting place for the bank regulators of many countries, a multilateral regulatory authority and a ***clearing house*** for many nations' ***reserves*** (i.e. foreign exchange). See ***Tim Hindle,*** Pocket Finance, The Economist, 2007, pp. 35–36.
37. Investments made and loans forwarded by banks are known as risky assets.

38. The capital of a bank was classified into Tier-I and Tier-II. While Tier-I comprises share capital and disclosed reserves, Tier-II includes revaluation reserves, hybrid capital and subordinated debt of a bank. As per the provision Tier-II capital should not exceed the Tier I capital. The risk-weighting depends upon the type of assets—for example it is 100 per cent on private sector loans while only 20 per cent for short-term loans.

39. The RBI is a member of the Board of the BIS. The financial sector reforms commenced in India in the fiscal 1992–93 after the report submitted by the Narasimham Committee on Financial system (CFS).

40. ***Committee on Banking Sector Reforms*** (M Narasimhan Committee-II), MoF, GoI, New Delhi, April 1998.

41. ***Economic Survey 2006–07,*** MoF, GoI, N. Delhi.

42. D. M. Nachane, Partha Ray and Saibal Ghosh, ***India Development Report 2004–05,*** Oxford University Press, N. Delhi, 2005, p. 171.

43. ***IDR 2004-05,*** op. cit., p. 172.

44. G-10 comprises Belgium, Canada, France, Germany, Italy, Japan, The Netherlands, Sweden, UK, and USA; later the group incorporated Luxembourg, Switzerland and recently Spain in its fold.

45. ***Bank of International Settlemets,*** Basel, Switzerland, May 15, 2012.

46. ***Reserve Bank of India,*** MoF, GoI, New Delhi, May 5, 2012.

47. **Basel III** norms prescribe a minimum regulatory capital of 10.5 per cent for banks by January 1, 2019. This includes a minimum of 6 per cent ***Tier I*** capital, plus a minimum of 2 per cent ***Tier II*** capital, and a 2.5 per cent capital conservation buffer. For this buffer, banks are expected to set aside profits made during good times so that it can be drawn upon during periods of stress.

48. The working group was set up in December 1997 under the chairmanship of Y. V. Reddy (the then Deputy Governor, RBI) which submitted its report in June 1998.

49. 'Other' deposits with RBI comprise mainly: (i) deposits of quasi-government; other financial institutions including primary dealers, (ii) balances in the accounts of foreign Central Banks and Governments, and (iii) accounts of international agencies such as the International Monetary Fund.

50. Y. V. Reddy, the RBI Governor, ***The Economic Times,*** N. Delhi, September 11, 2006.

51. S. Sundararajan, ***Book of Financial Terms,*** Tata McGraw-Hill, N. Delhi, 2004, p. 44.

52. Ibid.

53. As per the latest update by the ***RBI,*** May 11, 2012.

54. The part of 'Authorised Capital' (the limit upto which a company can issue shares) which has been actually 'paid' by the shareholders is known as the 'Paid-up Capital' of a company. [for detailed analysis of different kind of 'Capitals' of a company refer the *Chapter 14: Security Market in India*].

55. Though this sub-topic originally belongs to the *Chapter 14: Security Market in India*, it has been discussed here to make the new guidelines of setting-up banks an 'easy-to-understand' thing for the readers.

56. **Mutual Benefit Society** (also known *globally* as 'benefit society' or 'mutual aid society') is an organization, or voluntary association formed to provide *mutual aid, benefit,* or *insurance for relief* from common difficulties. Such organizations may be formally organized with charters and established customs, or may arise *ad hoc* to meet unique needs of a particular time and place. They may be organized around a shared ethnic background, religion, occupation, geographical region or other basis. Benefits may include money or assistance for sickness, retirement, education, birth of a baby, funeral and medical expenses, unemployment. Often benefit societies provide a social or educational framework for members and their families to support each other and contribute to the wider community.

    A benefit society may have some common features – members having equivalent opportunity in the organization; members having equivalent benefits; aid goes to needy (stronger helping the weaker); payment of benefits by collection of funds from the members; educating others about a group's interest; preserving cultural traditions; and mutual defence.

    Examples of benefit societies include *trade unions, self-help groups,* etc. It is believed that such societies predate human culture are found around the world.

13

INSURANCE IN INDIA

*Insurance is a kind of gambling in reverse – a major form of 'risk spreading' – one person's risk which would be large, is spread around to make it small for a large number of people – in this process it serves two purposes – provides social security net to people and helps in nation-building by making available investible capital.**

- Definition
- Insurance Industry
- Insurance Reforms
- Export Credit guarantee Corporation (ECGC)
- National Export insurence Account (NEIA)
- The Challenge Ahead

* *See Paul A Samuelson and William D Nordhaus, 'Economics', The McGraw-Hill Company, N. York, USA, 2005, pp. 210-212. Also see the LIBNA, 1956 and GIBNA, 1971 of the GoI.*

DEFINITION

In economic terms, anything used to cut down the risk is known as ***insurance***. But in familiar terms, insurance is provided by an insurance company which covers a person's life (called life segment) or covers loss of assets, property (called non-life or general segment). The insurance policies are purchased at fixed premiums.

INSURANCE INDUSTRY

LIC

The life insurance business/industry in the country was nationalised by the Government of India in 1956 and a fully government-owned company, the Life Insurance Corporation of India (LIC) was set up (at that time 245 Indian and foreign companies were playing in the life segment of insurance). Opening of private life insurance companies was prohibited at the same that time. The LIC was called an investment institution by the government.

The nationalisation was motivated by twin objectives—*first*, to spread the message of life insurance for greater social security and *secondly,* to mobilise people's savings (collected as premiums) for nation building. The LIC had been the biggest investor in the government's procces of planned development purchasing government securities (G-Secs.) and equities of the big asset public sector undertaking (PSUs).

The market share of these insurers was 68.84 per cent and 31.16 per cent respectively in the corresponding period of 2010-11 *(Economic Survey 2012-13)*.

GIC

In 1971, the Government nationalised the private sector companies (107 Indian and foreign companies) playing in the general insurance segment and a government company the General Insurance Corporation of India (GIC) was formed in 1972. The GIC started operation on January 1, 1973 with its four holding companies:

1. National Insurance Company Ltd.
2. New India Assurance Company Ltd.
3. Oriental Fire and Insurance Comany Ltd.
4. United India Insurance Company Ltd.

In the era of economic reforms, two major changes took place in this area—

(i) In November 2000 the GIC was notified as the Indian Reinsurer[1]

(ii) In March 2002 the GIC was withdrawn from holding company status of the four public sector general insurance companies. Now these four companies are directly owned by the Government of India[2].

The market shares of the public and private insurers are 57.80 and 42.20 per cent in 2011-12 as

against 59.07 and 40.93 in the previous year (Economic Survey 2010).

INSURANCE REFORMS

Under the process of economic reforms an Insurance Reforms Committee (IRC) was set up in April 1993 under the chairmanship of the ex-RBI Governor R N Malhotra. The committee handed over its report (January 1994) with the following major suggestions:[3]

(i) Decontrolling insurance sector i.e. allowing Indian as well as foreign private sector insurance companies to enter the sector (the Government did it in 1999 passing the *IRDA Act*).

(ii) Restructuring the LIC and the GIC and cutting down the government's holding in them to 50 per cent (no follow up still but the private insurance companies demanding it anxiously. The NDA government had taken steps in this area but the UPA government has no such plans.) Late 2012, the government started sale of the LIC shares but to public sector undertakings - seen as a welcome move.

(iii) Delinking GIC and its four subsidiaries (which was done in 2000).

(iv) Discarding the system of licensing of surveyors by the controller of Insurance.

(v) Restructuring the Tariff Advisory Committee.

(vi) Setting up a regulatory anthority for the insurance industry (the IRDA set up in 2000).

IRDA

The Insurance Regulatory and Development Authority (IRDA) was set up in 2000 (the Act was passed in 1999) with one chairman and five members (two as wholetime and three as part-time members) appointed and nominated by the Government. The authority is responsible for the regulation, development and supervision of the Indian insurance industry.

There are 29 insurance companies in India (15 in life segment and 14 in the non-life segment) which have been able to cover 40 million lives in the country. Out of the local life and non-life segment, insurance coverage in the rural areas have a share of 17 per cent and 14 per cent respectively, still too much needs to be done for the development of insurance in the country. (See the Select Model Answers on the topic.)

AICIL

The Agricultural Insurance Company of India Ltd. (AICIL) was set up in 2002 in the public sector to look after the National Agricultural Insurance

Schemes (NAIS) of 1999[4]. Till its arrival the responsibility was on the GIC whose losses were supposed to be reimbursed by the Central Government. Now the GIC does not play this role.

Public Sector Insurance Companies

There are six public sector insurance companies operating in the country—one in life segment (LIC), four in the non-life segment and one in the agriculture sector (AICIL).

Reinsurance

When an insurance company gets insurance coverage on its insurance policies, it is considered a case of reinsurance. For the development of insurance in an economy the presence of reinsurance companies is a precondition. It becomes an essential precondition if the economy is trying to develop and expand insurance with the active participation of the private sector insurance companies. This made the Government convert the GIC into a re-insurance company in 2000—this is the sole re-insurer in India, that too in the public sector. (Nobody can be a better insurer or reinsurer than the Government itself!).

Deposit Insurance and Credit Guarantee Corporation (DICGC)

DICGC was set up by merging the Deposit Insurance Corporation (1962) and the Credit Guarantee Corporation (1971) in 1978. While Deposit Insurance had been introduced in India out of concerns to protect depositors, ensure financial stability, instill confidence in the banking system and help mobilise deposits, the establishment of the Credit Guarantee Corporation was essentially in the realm of affirmative action to ensure that the credit needs of the hitherto neglected sectors and weaker sections were met. The essential concern was to persuade banks to make available credit to not so creditworthy clients. After the merger, the focus of the DICGC had shifted onto credit guarantees. This owed in part to the fact that most large banks were nationalised. With the financial sector reforms undertaken in the 1990s, credit guarantees have been gradually phased out and the focus of the Corporation is veering back to its core function of Deposit Insurance with the objective of averting panics, reducing systemic risk, and ensuring financial stability.

EXPORT CREDIT GUARANTEE CORPORATION (ECGC)

The overseas projects undertaken by the Indian companies face many ***political*** and ***commercial risks*** in the importing countries. To provide adequate credit insurance cover to such firms, the government has set up the Export Credit Guarantee Corporation of India Ltd. (ECGC) under the Ministry of Commerce and Industry, for medium and long term exports. But owing to its own limitations, at times it is difficult for ECGC to cover pure commercial risks in issues like long repayment period, the large value of contracts, difficult economic and political conditions of the importing country, together with the fact that ***reinsurance*** cover is generally not available for such projects.[5] Many times such projects look necessary considering the economic and political relationship of India with the proposed importing country. It means that in the absence of credit insurance cover, the ability of Indian exporters to go for such export projects is hampered. It should be noted that in many developed economies such projects are covered and underwritten on government account[6].

NATIONAL EXPORT INSURANCE ACCOUNT (NEIA)

For facilitating the service of the ECGC (discussed above) the Government of India did set up the National Export Insurance Account (NEIA) in March 2006 to promote medium and long term export

by providing credit insurance support in the cases where ECGC was not able to provide credit cover on its own because of purely commercial reasons[7] :

(i) The corpus given to the account was `66 crore, raised to `246 crore by 2007–08 and will be enhanced to `2000 crore in the Eleventh Plan (2007–12).

(ii) Resources of the NEIA will be the corpus, the premium income, interest income and recovery of all the claims paid.

(iii) As per the provision, an exposure equal to ten times corpus can be taken by the NEIA.

The NEIA can cover projects which fulfill the following criteria[8] :

(i) The project by itself should be commercially viable;

(ii) The project should be strategically important for India, with regard to economic and political relationship of India with the importing country; and

(iii) The exporter should be capable of executing the contract, as evident from his previous track record.

The use and benefits of the NEIA need to be publicised among its beneficiaries. Meanwhile, many export projects pertaining to Indonesia, Vietnam, Iran, Sudan, etc. are under way. The NEIA will facilitate potential project exporters to enter the international trade area, as it is expected[9] to be so. In the era of globalisation it has been praised as a welcome development by the experts and the trade people alike.

THE CHALLENGE AHEAD

Since the opening up of the insurance sector, the number of participants in the insurance industry has gone up from seven insurers (including the Life Insurance Corporation of India [LIC], four public-sector general insurers, one specialized insurer, and the General Insurance Corporation as the national re-insurer) in 2000 to 52 insurers as on 30 September 2012 operating in the life, non-life, and re-insurance segments (including specialized insurers, namely the Export Credit Guarantee Corporation and Agricultural Insurance Company [AIC]). Four of the general insurance companies, viz. Star Health and Alliance Insurance Company, Apollo Munich Health Insurance Company, Max BUPA Health Insurance Company, and Religare Health Insurance Company function as standalone health insurance companies. Of the 23 insurance companies that have set up operations in the life segment post opening up of the sector, 21 are in joint ventures with foreign partners. Of the 21private insurers who have commenced operations in the nonlife segment, 18 are in collaboration with foreign partners.

After the state monopoly in the insurance sector was dismantled and private players' entry allowed, the IRDA has played a crucial role in the development and expansion of the sector, there is no doubt in it. But still the sector faces many challenges which, if only tackled well may one say that insurance is serving the interests of the insuring companies and the covered alike. As per the concerned experts, the major challenges Indian insurance is facing today may be seen as given below:

1. As per various estimates, only 20 per cent of the insurable Indian population is life-insured; the share of India in global life insurance is just 0.66 per cent; and life insurance penetration

is at present 2.53 per cent (2004) in the country.[10]

The message of life insurance needs to be publicised among the population, specially in the rural areas. Moreover, social security schemes should be expanded to cover the poor masses who lack the premium-paying capacity.

2. Experts suggest that health insurance could emerge among the most important factors of improving human development in the country if expanded in a focussed way and via an ***action plan.*** It is estimated that around 15 per cent of the Indian population is covered under some form of pre-payment on healthcare which includes employees and beneficiaries covered under ESIS, CGHS, Armed forces, Central Police organisations, Railways, employer self-funded schemes, the PSUs and pensions covered under health insurance.[11] The health insurance penetration is at present at 1.536 per cent only (2005–06). Besides the LIC, the private players should be promoted to enter the foray, specially in the rural areas.

3. After the general insurance industry was opened up (2000) for the private sector participation, the experience has been positive[12]. Its growth compares favourably with that of many other emerging markets and is in line with global benchmark of two to three times the growth in GDP[13]. As the economy is on a strong growth path and the capital expenditure planned across industries is estimated to be over ` 9,00,000 crore over the next four to five years, a better scope for the general insurance expansion is probable[14]. The growth in both commercial and personal lines of general insurance business reflects positive trends. Over 70 per cent of India's population lives in rural areas and along with organised financial services, general insurance companies are also expanding into these sectors.

4. People in their lives experience financial difficulties that can affect the entire family negatively, this is more true about the poor masses in India.

This is why the experts suggested for the provision of **micro insurance.** A relatively new concept, micro insurance is today provided to the beneficiaries of the micro finance covering the finance amount, reducing the risk of the clients as well as the micro finance institutions (MFIs)[15]. The concept of micro insurance has been developed by the private insurance company Aviva Life Insurance (in partnership with MFIs) which has forged alliances with banks like Canara Bank, P&SB, RRBs, 23 cooperatives, etc. to promote micro finance.

Micro insurance has evolved in the past two decades of research in micro finance and has seen growth in countries like Sri Lanka, Philippines in the last decade[16]. Here NGOs and people's organisations are allowed to register themselves as micro insurance companies which sell such insurance. As they cover the risk themselves, they are allowed to ***reinsure*** with one of the large global companies like Swiss Re or Munich Re. Same model is suggested for India but for this to happen drastic changes in the existing insurance rules are required[17].

5. Many of the experts believe that insurance industry should benefit the insurers, reinsurers as well as the insured. The ***social purpose*** of the insurance sector is never praiseworthy to be marginalised by the corporate interests (be domestic or foreign)—at least it does never taste good in India which needs a strong social safety net.[18]

6. Almost all of the private insurance companies in India have been demanding that the government-owned insurance companies (i.e. LIC and the four general insurance companies)

should be converted into private sector companies. Their reasons are logical as in comparison with the government-owned insurance companies, private companies are always ready with highly attractive and lucrative insurance schemes but they have not been able to attract the clients for them. Therefore, the private insurance companies have been fetching huge operational losses due to lack of the desired level of their expansion and the overhead expenditure.[19]

Insurance Penetration

The growth in the insurance sector is internationally ***measured*** based on the standard of insurance penetration. Insurance penetration is defined as the ratio of premium underwritten in a given year to the gross domestic product (GDP). Likewise, insurance density is another well recognized benchmark and is defined as the ratio of premium underwritten in a given year to total population (measured in US dollars for convenience of comparison). The Indian insurance business has in the past remained under-developed with low levels of insurance penetration. Post liberalization[20] the sector has succeeded in raising the levels of insurance penetration from 2.3 (life 1.8 and non-life 0.7) in 2000 to 5.1 (life 3.4 and non-life 0.7) in 2011.

As per the ***Economic Survey 2012-13***, despite the growth in the insurance sector that was witnessed during the last few decades, insurance penetration and density remained low as compared to other developing countries of the world. It was felt that various legislative provisions were archaic and needed revision in line with the changing market conditions. Accordingly, the government introduced the Insurance Laws (Amendment) Bill 2008 in the Rajya Sabha on 22 December 2008. Based on the recommendations of the Standing Committee, the official amendments to the Insurance Laws (Amendment) Bill 2008 are proposed to be introduced at the earliest. The ***Survey*** further adds that

i. limited choice and high cost of providing covers, and

ii. assessing claims

are some of the issues that need to be suitably addressed to make insurance funds an effective means of channellizing savings to investments.

Policy Initiatives

Committed to expand and strengthen the insurance industry in the country (following the recommendations of the Malhotra Committee Report, 1993), the GoI has taken the following policy initiatives[21] in the recent years:

1. **Health Insurance:** The Insurance Regulatory Development Authority (IRDA) has been taking a number of proactive steps as part of the initiatives for the spread of health insurance. It had set up a National Health Insurance Working Group in 2003, which provided a platform for the various stakeholders in the health insurance industry to work together and suggest solutions on various relevant issues in the sector. The IRDA is also co-ordinating with and supporting insurance industry initiatives in standardizing certain key terminology used in health insurance documents, for better comprehension and in the interest of policyholders. The ***General Insurance Council,*** comprising all non-life insurers, evolved a consensus on a uniform

definition of 'preexisting diseases' and its exclusion wording, which has earlier been an expression with many definitions, still more interpretations, and certainly a whole lot of grievances. Such standardization, effective 1 June 2008 will help the insured by minimizing ambiguity and also by better comparability of health insurance products. Also, with effect from 1 October 2011, portability in health insurance has been started in which an insured, if not happy with services or the product of the existing insurer, can change to another insurer whilst enjoying the benefits (especially that of pre-existing diseases) of her/his existing policy.

2. **Micro Insurance:** Micro insurance regulations issued by the IRDA have provided a fillip to propagating micro insurance as a conceptual issue. With the positive and facilitative approach adopted under the micro insurance regulations, it is expected that all insurance companies would come out with a progressive business approach and carry forward the spirit of regulations thereby extending insurance penetration to all segments of society. Presently, there are 10,482 micro insurance agents operating in the micro insurance sector.

3. **Insurance Laws (Amendment) Bill 2008:** The Bill aimed to amend the Insurance Act 1938, the General Insurance Business (Nationalisation) Act 1972, and the Insurance Regulatory and Development Authority Act 1999. The Standing Committee on Finance has submitted its report to the Parliament on 13 December 2011. The report of the Committee is under examination by the government. Amendments to the LIC Act 1956: The LIC (Amendment) Bill, 2011 was passed by Parliament on 12 December 2011. The amendments will enable the LIC to raise its equity capital from Rs. 5 crore to Rs. 100 crore and create a *reserve fund* to be used for its *business expansion* and meeting its *corporate social responsibility.*

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1. ***India 2002,*** Pub. Div., GoI, N. Delhi
2. ***Economic Survey 2002–03,*** MoF, GoI, N. Delhi.
3. R. N. Malhotra headed ***Insurance Reforms Committee,*** GoI, N. Delhi, January 1994.
4. ***Economic Survey 2002–03,*** MoF, GoI, N. Delhi.
5. Due to its underwriting constraint, the ECGC is unable to cover such projects on its own.
6. As for example the USA, France, the UK and many other Euro-American economies underwwrite such medium and long term projects in the governments' account. The SEIA also covers only medium- and long-term export projects only.
7. Announced while setting up the NEIA, Ministry of Commerce and Industry, GoI, N. Delhi, March 9, 2006.
8. Ibid.
9. S. Prabhakaran, Executive Director, ECGC, Mumbai in ***Survey of Indian Industry 2007,*** The Hindu, p. 84.
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12. Sandeep Bakhshi, CEO & MD, ICICI Lombard General Insurance Company, Mumbai, ***Survey of Indian Industry 2007***, op. cit., p. 99.
13. Ibid.
14. Ibid.
15. Vivek Khanna, Director, Aviva India, ***Survey of Indian Industry 2007,*** op. cit., p. 102.
16. Ibid.
17. It has been beautifully shown taking example of the Self-employed Women's Association (SEWA) by Renana Jhabvala and Ravi Kanbur in the Kaushik Basu edited ***India's Emerging Economy,*** Oxford Univ. Press, N. Delhi, 2005, pp. 309–11.

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19. G. V. Rao, CMD, Oriental Insurance Co. Ltd., ***Survey of Indian Industry 2007,*** The Hindu, pp. 87–90.
20. ***Economic Survey 2012-13,*** op. cit., p. 127.
21. ***Economic Survey 2011-12,*** op. cit., pp. 128-129.

14

SECURITY MARKET IN INDIA

*Had there been no security market – undoubtedly, the most fascinating segment of the financial market – there won't have been the big MNCs and TNCs in the world. Once the world moved towards the process of globalisation, the potential of this market has increased exponentially – its capacity of resource mobilisation is just naybody's guess!**

- Definition
- Primary and Secondary Markets
- Stock Exchange
- SEBI
- Important Terms of Stock Market
- Foreign Financial Invesotors
- Angel Investor
- QFIS Scheme
- Participatory Notes (PNs)
- Short Selling
- RGESS
- Credit Default SWAP (CDS)
- Securitisation
- Corporate Bond in India
- Pension Sector Reforms

** As many documents of the WTO, World Bank and OECD have accepted many times.*

DEFINITION

The segment of a financial market of an economy from long-term capital is raised via instruments such as shares, securities, bonds, debentures, mutual funds is known as the security market of that economy.

A security market has components such as a security regulator (SEBI in India), stock exchanges, different share indices, brokers, FIIs, jobbers, etc. There are different kinds of transactions which take place in a security market such as badla, reverse badla, future trading, insider trading (not allowed), private placement, etc.

PRIMARY AND SECONDARY MARKETS

Every security market has two complementary markets—Primary and the Secondary. The market in which the instruments of security market are traded (procured) directly betweefn the capital-raiser and the instrument purchaser is known as the primary market.

As for example, a share being directly purchased by anybody from the issuer which may be the company itself. The person is known as the primary shareholder. The market where the instruments of security market are traded among the primary instrument holders is known as the *secondary market*. Such transactions need an institutionalised floor for their trading which is made available by the stock exchanges.

STOCK EXCHANGE

A physically existing institutionalised set-up where instruments of security stock market (shares, bonds, debentures, securities, etc.) are traded. It serves the following major functions:

(i) Makes a floor available to the buyers and sellers of stocks and liquidity comes to the stocks. It is the single most important institution in the secondary market for securities.

(ii) Makes available the prices of trading as an important piece of information to the investors.

(iii) By following institutionalised rules and procedures, it ensures that the participants in the stock market live up to their commitments.

(iv) Passes updated informations to the enlisted companies about their present stockholders (so that they can pass on dividends etc. to them).

(v) By publishing its 'Index', it fulfills the purpose of projecting the moods of the stock market.

World's first stock exchange was established in Antwerp, Belgium (then part of the Netherlands) in 1631, the London Stock Exchange opened in 1773 and then Philadelphia Stock Exchange (the first in the New World) opened in 1790.[1] The first stock exchange in India, the Bombay Stock Exchange known as *The Native Share and Stock Brokers' Association* was set up in 1870 (under a tree!).[2]

Top five largest stock exchanges (on the basis of market capitalisation) of the world in their decreasing order are—the New York Stock Exchange, the NASDAQ, the Tokyo Stock Exchange, the London Stock Exchange and the Bombay Stock Exchange.[3]

Trading in the stock exchanges takes place via the mediators known as the *brokers,* the *jobbers*, the *market-maker* (discussed later in this chapter).

As per the latest information[4], presently, there are a total number of 26 stock exchanges operating in India – 7 at the national level and rest 19 at the regional level (one of it, Coimbatore Stock Exchange recently sought for withdrawal of recognition, the matter is sub-judice under SEBI). A brief account of the 'national level stock exchanges' is given below.

NSE

The National Stock Exchange of India Ltd. (NSE) was set up in 1992 and became operationalised in 1994. The sponsors of the exchange are financial institutions, including IDBI, LIC and GIC with IDBI as its promotor.

It has a 50 share index and a 500 share index known as S&P CNX-50 (Nifty Fifty) and S&P CNX-500, respectively.

OTCEI

Though the Over the Counter Exchange of India Ltd (OTCEI) was set up in 1989, it could commence trading only in 1992. India's first fully computerised stock exchange was promoted by the UTI, ICICI, SBI Cap among others, in order to overcome problems such as lack of transparency and delays in settlements prevalent in the older stock exchanges. Another important goal of the exchange was to allow stock market exposure to comparatively smaller companies (companies with paid-up capital from Rs. 30 lakh to Rs. 25 crore are enlisted here). Trading in this exchange takes place via market-makers and commission is fixed.

ISE

The Interconnected Stock Exchange of India (ISE) is basically a single floor of India's 15 regional stock exchanges (RSEs), set up in 1998. The RSEs were provided increased reach through this. It is a web-based exchange.

BSE

The Bombay Stock Exchange Ltd. (BSE), earlier a regional stock exchange, converted into a national one in 2002. The *biggest* in India, it accounts for almost 75 per cent of total stocks traded in India and is the *fifth* largest in the world (on the basis of market capitalisation).

There are at present four Indices connected with the BSE:

(i) *Sensex:* The sensitive index (i.e. Sensex) is a 30 stocks index of the BSE which was enlarged to include 50 stocks in 2000 but soon was cut down to the original level. This index represents the Indian stock market.

(ii) *BSE-200:* This is a 200 stock share index of the BSE (including the 30 stocks of the Sensex) which has its Dollar version too—*the Dollex*.

(iii) *BSE-500:* In mid-1999, the BSE came up with a 500-stock index representing major industries and many sub-sectors of the economy with information technology getting a significant weightage.

(iv) *National Index:* An index of 100 stocks being quoted nationwide (Bombay, Delhi, Kolkata, etc.) was developed to give broader/wider representation of the stock market since the Sensex consists of only 30 stocks. The 30 stocks of the sensex are included in the National Index.

This index is computed by the Statistics Department of the BSE hence it is called the BSE National Index (BSENI).

Indo Next

A new stock exchange to promote liquidity to the stocks of the small enterprises (SMEs) was launched in 2005 jointly and medium the BSE and the FISE (Federation of Indian Stock Exchanges, representing 18 regional stock exchanges).

- It is better known as the *BSE Indo Next*. It was also an effort to rejuvenate the RSEs which were facing falling volumes of trading on their floors. Due to absence of trading at the RSEs, the stocks of the SME, has become illiquid.

The BSE will transfer all its B1 and B2 groups to this exchange. The RSEs also transfer their enlisted companies to the new exchange.

Now the RSEs will be able to use the BSE network online—the ‘Webex’.

SME Exchanges: *BSESME* and *Emerge*[5]

SME exchange is a stock exchange dedicated for trading the shares of small and medium scale enterprises (SMEs) who, otherwise, find it difficult to get listed in the main exchanges. The concept originated from the difficulties faced by SMEs in gaining visibility or attracting sufficient trading volumes when listed along with other stocks in the main exchanges.

To be listed on the SME exchange, the post-issue paid-up capital of the company should not exceed Rs. 25 crores. This means that the SME exchange is not limited to the small and medium Scale enterprises (which are defined under the ‘Micro, Small And medium enterprises Development Act, 2006’ as enterprises where the investment in plant and machinery does not exceed Rs. 10 crores). As of now, to get listed in the main boards like, National Stock Exchange, the minimum paid-up capital required is Rs. 10 cr and that of the BSE is Rs. 3 cr. Hence, those companies with paid-up capital between Rs. 10 cr to Rs. 25 cr have the option of migrating to the Main Board/or to the SME exchange. The companies listed on the SME exchange are allowed to migrate to the Main Board as and when they meet the listing requirements of the Main Board. There shall be compulsory migration of the SMEs from the SME exchange, in case the post-issue paid-up capital is likely to go beyond the Rs 25 crore limit.

World over, trading platforms/exchanges for the shares of SMEs are known by different names such as Alternate Investment Markets or Growth Enterprises Market, SME Board etc. Some of the known

markets for SMEs are *AIM* (Alternate Investment Market) in UK, *TSX Ventures* in Canada, *GEM* (Growth Enterprise's Market) in Hong Kong, *MOTHERS* (Market of the High-Growth and Emerging Stocks) in Japan, *Catalist* in Singapore and *Chinext*, the latest initiative in China [see 'World Federation of Exchanges' for latest comparative idea].

Globally, most of these SME exchanges are still at an evolving stage considering the many hurdles they face –

- Declining prices of listed stocks and their illiquidity,
- A gradual reduction in new listings and decline in profits of the exchanges etc. (for instance, *AIM* had three predecessors; *CATALIST* succeeded *SESDAQ* with new regulations and listing requirements).
- In most jurisdictions, idea of a separate exchange for SMEs have become unviable and hence tend to be platforms of existing exchanges, perhaps cross-subsidized by the main board/exchange.

In India, similarly, after the two previous attempts – ***OTCEI*** (Over the Counter Exchange of India, 1989) and ***Indonext*** – the market regulator, SEBI, on May 18, 2010 permitted setting up of a dedicated stock exchange or a trading platform for SMEs. The existing bourses/stock exchanges in India, BSE and NSE went live on 13 March, 2012 with a separate trading platform for small and medium enterprises (SMEs). BSE has named its SME platform as **BSESME** while NSE has named it as **Emerge**.

Unlike in India, many of these SME exchanges in various countries operate at a global level, due to smallness of the market, allowing for listing by both domestic as well as foreign companies. Though the names suggest that they are set up for SMEs, these exchanges hardly follow the definition of SMEs in their respective jurisdictions. Also, many of them follow a 'Sponsor-supervised' market model, where sponsors or nominated advisors decide if the listing applicant is suitable to be listed or not, i.e., generally no quantitative entry criteria like track record on profitability or minimum paid-up capital or net worth etc. are specified to be listed in these exchanges. Instead, they are designed as 'buyers beware' markets for informed investors. SEBI has also designed the SME exchanges in a similar format with provisions for ***'market making'*** for the specified securities listed on the SME exchange.

As is the case globally, certain relaxations are also provided to the issuers whose securities are listed on the SME exchange in comparison to the listing requirements in Main Board (such as in BSE and NSE, in the case of India), which include –

(i) Publication of financial results on 'half yearly basis', instead of 'quarterly basis', making it available on their websites rather than publishing it.

(ii) Option of sending a statement containing the salient features of all the documents instead of sending a full Annual Report.

(iii) No continuous requirement of minimum number of shareholders, though at the time of IPO there needs to be a minimum of 50 investors etc.

(iv) The existing eligibility norms like track record on profits, net worth/net tangible assets conditions etc. have been fully relaxed for SMEs as is the case globally.

(v) However, no compromise has been made to corporate governance norms.

Common Facts about the National Stock Exchanges

Before the arrival of national level stock exchanges, India was not having any exchange of national status—better say there was no Indian stock market but stock markets showing only regional pictures. Besides, the national stock exchanges did solve some major problems of stock market, we may also call their arrivals as part of the stock market reforms in India. The common features of these exchanges are:

(a) all are situated in Mumbai;

(b) all do screen-based trading (SBT);

(c) all have their trading terminals in the major cities of the country;

(d) all are web-enabled;

(e) all are limited liability companies;

(f) the brokers registered here have no say in either the ownership or the management of the exchanges;

(g) All are counted among the best and the most technology-equipped stock exchanges in the world.[6]

Players in the Stock Exchanges

Broker

Broker is a registered member of a stock exchange who buys or sells shares/securities on his client's behalf and charges a commission on the gross value of the deal—such brokers are also known as *commission brokers*.

Brokers who offer services such as investment advice, clients' portfolio planning, credit when a client is buying on margin other than their traditional commission job are known as *full service brokers*. In India such brokers are just coming up.

Jobber

A jobber is a broker's broker or one who specialises in specific securities catering to the need of other brokers—in India also known as '*Taravaniwallah*' (in the BSE).[7] A jobber is located at a particular trading post on the floor of the stock exchange and does buying and selling for small price differences, called the *spread*. He has no contact with the investing public.

In the London Stock Exchange he is called a *market-maker* while in the New York Stock Exchange he is called a *specialist*. The Bombay Stock Exchange has made it mandatory for every company with a share capital of over Rs. 3 cr to appoint jobbers or market-makers if it seeks enlistment. Such an arrangement enables investors to buy and sell shares on the stock exchange and thus liquidity increases.

Market –Maker

Functions as an intermediary in the market ready to buy and sell securities. He simultaneously quotes

two-way rates—like a jobber basically with the only difference that he quotes two-way rates, for buying and selling at the same time.[8]

On the floor of India's OTCEI (Over the Counter Stock Exchange of India Ltd.), only market-makers are allowed to play. In the money market of India, the Discount and Finance House of India (DFHI) is the chief market–maker[9].

Since he quotes the selling price while buying a particular share, he makes market for that share, hence such a name.

The NASDAQ of the USA is a market– maker's stock exchange where they are connected by the web-enabled trading terminals.

SEBI

The regulator of Indian stock market, set up under the *Security and Exchange Board of India Act, 1992* (as a non-statutory body set on April 12, 1988 through a Government Resolution in an effort to give the Indian stock market an organised structure) with its head office in Mumbai. Its initial paid-up capital was Rs. 50 crore provided by the promoters—the IDBI, the IFCI and the ICICI.

The Board of SEBI comprises 9 members excluding the Chairman—one member each from the Ministries of Finance and Law, one member from the RBI and two other members appointed by the Central Government. It has four full-time members (including the Chairman).

Main functions/powers of the Board as per the *SEBI Act, 1992* are:

(i) Registering and stock exchanges, merchant banks, mutual Funds, underwriters, registrars to the issues, Brokers, Sub-brokers, transfer agents and others.

(ii) Levying various fees and other charges (as 1 per cent of the issue amount of every company issuing shares are kept by it as a caution money in the concerned stock exchange where the company is enlisted).

(iii) Promoting investor education.

(iv) Inspection and audit of stock exchanges and various intermediaries.

(v) Performing other concerned functions as may be prescribed from time to time.

Commodity Trading

Commodity trading happens similar to 'stocks' (shares, securities, debentures, bonds) trading in the stock market. However, commodities are actual physical goods such as corn, silver, gold, crude oil, etc. Futures are contracts for commodities that are traded at a futures exchange like the Chicago Board of Trade (CBOT). Futures contracts have expanded beyond just commodities, now there are futures contracts on financial markets like foreign currencies, interest rates, etc.

Commodity Futures serve a great purpose in any economy. As we see in the case of agricultural commodity – their prices play a key role in determining the fortune of the agriculture and food processing industry in India. These prices undergo a *large degree of fluctuation*. Reasons for price fluctuation are crop failure, bad weather, demand-supply imbalance, etc. This fluctuation, in turn,

leads to a 'price risk'. This price risk is largely borne by the farmer and the industries where agricultural commodities are used as raw material. Commodity exchanges are associations that determine and enforce rule, and set procedures for trading of commodities. The main objective of the exchange is to protect the participants from adverse movement in prices by facilitating futures trading in commodities.

If the participants *hedge* themselves against this price risk, then they would be able to insulate themselves against the inherent price fluctuations associated with agricultural commodities. One of the methods of doing this would be by using commodity exchanges as a trading platform. Apart from hedging against price risk, a commodity exchange helps in production and procurement planning as one can buy in small lots. Further as the exchange consists of various informed industry participants, *price discovery* is more efficient and discounts the local and global factors.

Let us take a very simple example to understand how trading on commodity exchanges help industry participants – a farmer who is producing wheat can sell 'wheat futures' on a commodity exchange. This will help him lock in a sale price of a specified quantity of wheat at a future date. Hence the farmer would now be able to get an assured price for his produce in future and any decline in the price of wheat would not impact his earnings. On the other hand, a user industry (e.g. a flour mill) could purchase the wheat futures from the exchange. Hence the flour mill would now be able to fix its future purchase cost for a specified quantity of wheat. Therefore, any increase in the price of wheat in future would not impact its cost of production.

However, what needs to be kept in mind is that farmers do not largely operate in the futures market. This is partly due to operational difficulties and lack of knowledge. Though, they observe the price trends emerging from a futures market and then decide what commodity in what proportion to cultivate.

In case of user industries, commodity exchanges help them to plan their production and determine their cost of production. Commodity exchanges are an effective tool to hedge price risk. However, the government needs to improve infrastructure, put in place vigilant governing systems, etc. to encourage trading on these exchanges.

Big money started flowing into commodity futures with the advent of online multi-commodity exchange. The boom, which began when the stock market was sluggish, has surprisingly not waned even after the Sensex crossed 20,000 (by 2004-06). High stakes, long trading hours and comparatively little knowledge about the derivative products have underscored the role of a regulator. The Forward Markets Commission (FMC), which for decades was entrusted with the job to curb forward trades, now has the job to develop and regulate the commodity futures market.

FMC

The Forward Markets Commission (FMC) is a statutory body set up under the *Forward Contracts (Regulation) Act, 1952.* It functions under the administrative control of the Department of Consumer Affairs, Ministry of Consumer Affairs, Food & Public Distribution. Headquartered at Mumbai with one regional office at Kolkata, the Commission comprises a Chairman, and two members. The Commission provides ***regulatory oversight*** in order to ensure –

(i) Financial integrity (i.e., to prevent systematic risk of default by one major operator or group

of operators);

(ii) Market integrity (i.e., to ensure that futures prices are truly aligned with the prospective demand and supply conditions), and

(iii) Protection and promotion of the interest of consumers/non-members.

After assessing the market situation and taking into account the recommendations made by the *Board of Directors of the Commodity Exchange*, the Commission approves the rules and regulations of the ***Commodity Exchanges*** in accordance with which trading is to be conducted. It accords permission for commencement of trading in different contracts, monitors market conditions continuously and takes remedial measures wherever necessary by imposing various regulatory measures. At present, there are 21 commodity exchanges in India including three ***'national level'*** exchanges recognized for conducting futures/forward trading. The three national exchanges are –

1. Multi-commodity Exchange of India Ltd. (MCX), Mumbai.
2. National Commodity and Derivatives Exchange Ltd. (NCDEX), Mumbai.
3. National Multi-commodity Exchange of India Ltd. (NMCE), Ahmedabad.

In US, which has the *largest* commodity futures market, there are separate regulators for equities and commodities. Single regulator exists in China, UK, Australia, Hong Kong and Singapore. Japan has a different model for its derivatives market, with multiple product type based regulators.

Raising Capital in the Primary Market

There are three ways in which a company raises capital in the primary market—

Public Issue

A public offer is open for all Indian citizens, the most broad-based method of raising capital and the most prestigious, too (The Reliance Industries Ltd. is the biggest company of India in this category).

Rights Issue

Raising capital from the existing shareholders of a company, it means it is a preferential kind of issue restricted to a certain category of the public only.

Private Placement

Raising capital by selling shares to a select group of investors, usually financial institutions (FIs) but may be to individuals also. This is done through a process of direct negotiations (completely opposite to the public issue). The advantage of this route is the substantial saving a share issuing company makes on marketing expenses (but the risk of shifting loyalties of the investors in this route is also the highest!).

Recent times have seen such capital raising by many companies privately placing their shares to the foreign institional investors (FIIs) as a route to source foreign exchange in India, and that too quickly.

IMPORTANT TERMS OF STOCK MARKET

Scrip Share

A share given to the existing shareholders without any charge—also known as *bonus share.*

Sweat Share

A share given to the employees of the company without any charge.

Rolling Settlement

An important reform measure started in the Indian stock market in mid-2001 under which all commitments of sale and purchase result into payment/delivery at the end of the 'X' days later (where 'X' stands for 5 days. Some shares have X as one, two or three days, too). Today, all shares are covered under this provision.

Badla

When the buyers want postponement of the transaction–in Western world called *Contango.*

Undha Badla

When the sellers want postponement of the transaction—also known as the *reverse badla* or *backwardation.*

Futures

A trading allowed in shares where a future price is quoted for the shares and the payment and delivery takes place on the pre-determined dates.

Depositories

Started in 1996 under which stocks are converted into ***'paperless form'*** (dematerialisation of shares shortly known as the 'demat'). At present, two Public Sector depositaries (Mumbai) are functioning in India set up under the *Depositories Act, 1996*—

(i) NSDL (National Securities Depositories Ltd.)

(ii) CDSL (Central Depositories Services Ltd.)

Spread

The difference between the buying and selling prices of a share is called spread. Higher the liquidity of a share lower its spread and vice versa. Also known as Jobber's ***Turn*** **or** ***Margin*** **or** ***Hair cut.***

Kerb Dealings

The transactions of stocks which take place outside the stock exchanges—unofficially and take place after the normal trading hours.

NSCC

The National Securities Clearing Corporation (NSCC), a public sector company set up in 1996 takes the *counter party risk* of all transactions done at the NSE just as an intermediary guarantees all trades.

Demutualisation

A process started (2002) by SEBI under which ownership, management and trading membership was to be segregated from each other. No broker was to be on the Board of Directors or an office-bearer in a stock exchange.

This has been done in the case of all stock exchanges except three regional stock exchanges (RSEs) in India.

Authorised Capital

The limits upto which shares can be issued by a company—also known as the *nominal* or *registered* capital. This is fixed in the Memorandum of Association (MoA) and the Article of Association (AoA) of a company as required by the *Companies Act (Law)*.

Paid-up Capital

The part of the authorised capital of a company that has actually been paid by shareholders. A difference may arise because all shares authorised might not be *issued* or issued shares are only partly paid-up.

Subscribed Capital

The amount actually paid by the shareholders or have been committed by them for contribution.

Issued Capital

The amount which is sought by a company to be raised by issuing shares which cannot exceed the authorised capital of the company.

Greenshoe Option

A provision under which a company issuing shares for the first time is allowed to sell some additional shares to the public—usually 15 per cent, is also known as ***over-allotment provision***. It gets its name from the first company (Green Shoe Company, USA) which was allowed such an option.

Penny Stocks

The share which remains low-priced at a stock exchange for a comparatively longer period. Speculators may start hoarding them for hefty margins, this was seen in India in mid-2006. And since such stocks get hoarded, ultimately their market prices increase. The speculators earn profit after offloading (selling) these shares at high prices and others who purchase these shares ultimately might fetch huge losses because price rise of these stocks are unintentional or each intentional manipulation and nothing else.

ESOP

The Employee Stock Ownership Plan (ESOP) enables a foreign company to offer its shares to employees overseas. It was allowed in India (February 2005) provided that the MNC has minimum 51 per cent holding in its Indian company. Earlier a permission from the RBI was required for such an option.

SBT

Screen Based Trading (SBT) is trading of stock based on the electronic medium, i.e., with the help of computer monitor, internet, etc. First such trading was introduced in New York in 1972 by the bond broker ***Cantor Fitzgerald.*** India introduced it in 1989 at the OTCEI. Now it is carried out at all exchanges.

Derivatives

Derivative is a product whose value is derived from the value of one or more basic variables, called bases (underlying asset, index, or reference rate), in a contractual manner.

The underlying asset can be equity, forex, commodity or any other asset. For example, wheat farmers may wish to sell their harvest at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of this derivative is driven by the spot price of wheat which is the "underlying".

In the Indian context the *Securities Contracts (Regulation) Act, 1956* [SC(R)A] **defines derivative** to include –

(a) A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security.

(b) A contract, which derives its value from the prices, or index of prices, of underlying securities.

Derivatives are securities under the SC(R)A and hence the trading of derivatives is governed by the regulatory framework under the SC(R)A and are allowed to be traded on the floors of the stock exchanges.

Indian Depository Receipts (IDRs)

As per the **definition** given in the *Companies (Issue of Indian Depository Receipts) Rules, 2004,*

IDR is an instrument in the form of a depository receipt created by the Indian depository in India against the underlying equity shares of the issuing company. In an IDR, foreign companies would issue shares, to an Indian depository (say the National Security Depository Limited – NSDL), which would in turn issue depository receipts to investors in India. The actual shares underlying IDRs would be held by an Overseas Custodian, which shall authorise the Indian depository to issue of IDRs.

Just try to understand in a simple way. An IDR is a mechanism that allows investors in India to invest in listed foreign companies, including multinational companies, in Indian rupees. IDRs give the holder the opportunity to hold an interest in equity shares in an overseas company. IDRs are denominated in Indian Rupees and issued by a Domestic Depository in India. They can be listed on any Indian stock exchange. Anybody who can invest in an IPO (Initial Public Offer) is/are eligible to invest in IDRs. *In other words, what ADRs/GDRs are for investors abroad with respect to Indian companies, IDRs are for Indian investors with respect to foreign companies.*

But one question comes in mind. How does investing in IDRs differ from investing in shares of foreign company listed on foreign exchanges? Indian individuals can invest in shares of foreign companies listed on foreign exchanges only upto $200,000 and the process is costly and cumbersome as the investor has to open a bank account and demat account outside of India and comply with Know Your Customer (KYC) norms of respective companies. It also involves foreign currency risks. IDR subscription and holding is just like any equity share trading on Indian exchanges and does not involve such hassels.

StanChart is the **first** and the **only** issuer of IDRs in Indian markets which came out with its IDR issue in May 2010 through which it had raised Rs. 2,500 crore on high demand from institutional investors and was listed on the Bombay Stock Exchange and National Stock Exchange. Ten StanChart IDRs represent one underlying equity of the UK-listed bank. StanChart IDRs were due to come up for redemption on June 11, 2011.

SEBI came out with the new guidelines in June, 2011which ruled that after the completion of one year from date of issuance of IDRs, redemption of the IDRs will be permitted only if the IDRs are infrequently traded on the stock exchange in India. SEBI rules make it clear that if the annual trading turnover in IDRs in the preceding six calendar months before redemption is less than 5 per cent, then only the company could go into for redemption of IDRs. The regulator had said that the company issuing IDRs would have to test the frequency of trading the instrument on the bourses on a half-yearly basis ending June and December every year.

Shares 'at Par' and 'at Premium'

An ordinary share in India, in general, is said to have a ***par value (face value)*** of Rs. 10, though some shares issued earlier still carry a par value of Rs. 100. Par value implies the value at which a share is originally recorded in the balance sheet as 'equity capital' (this is the same as 'ordinary share capital'). SEBI guidelines for *public issues* by new companies established by individual promoters and entrepreneurs, require all new companies to offer their shares to the public *at par,* i.e. at Rs 10. However, a new company set up by existing companies (and of course existing companies themselves) with a track record of *at least five years* of consistent profitability are allowed to issue shares at a **premium.**

When a company issues shares at a premium, it is able to raise the required amount of capital from the public by issuing a fewer number of shares. For example, while a *new company* promoted by first time entrepreneurs intending to raise say, Rs. 1 crore, has to offer 10 lakh ordinary shares at Rs. 10 each (at par), an *existing company* may raise the same amount by offering only 2 lakh shares at Rs. 50 each (close to the market value of its shares). The latter is said to have issued its share at a '*subscription price*' of Rs. 50 (Rs. 10 in the case of the former company), at a premium of Rs. 40 (being the excess of subscription price over par value). In such a situation in India, the company's books of accounts will show Rs. 10 towards *share capital account* and Rs. 40 towards *share premium account*. It means that the higher the premium, the fewer will be the number of shares a company will have to service. For this very reason, following the policy of free pricing of issues in 1993, many companies came out with issues at prices so high that in many cases they were higher than their market prices, leading to under-subscription of such issues. The companies are, however, learning fast about the pitfalls of high pricing of shares and it is only a matter of time before the issue prices become more realistic.

In India, no company is allowed to issue shares at a *discount*, i.e., at a price below par. Again, in India, once a company has issued the shares, it cannot easily reduce its capital base, (i.e. *buy back* or *redeem*) its own shares.

This means that ordinary share capital is a more or less permanent source of capital, which normally a company is never under an obligation to return to the investors, because a shareholder who wishes to *disinvest* (i.e., get back the invested capital) can always do so by selling the shares to other buyers in the secondary market. Also, in India, a company receives no tax benefits for the dividends distributed. In other words, dividends are paid by the companies out of the earnings left after taxes and they get taxed once again at the hands of the investors.

FOREIGN FINANCIAL INVESTORS

Through the Portfolio Invesment Scheme (PIS), the foreign financial investors (FIIs) were allowed to invest in the Indian stock market – the FIIs having good track record register with SEBI as brokers. FIIs make investments in markets on the basis of their *perceptions* of expected returns from such markets. Their perceptions among other things are influenced by –

- the prevailing macro-economic environment;
- the growth potential of the economy; and
- the corporate performance in competing countries.

Increased FII inflows into the country during the year 2012 helped the Indian markets become one of the best performing in the world in 2012, recovering sharply from their dismal performance in 2011. At the end of December 2012, **1,759** FIIs were registered with SEBI with their net FII flows to India at US $ 31.01 billion[10] .These flows were largely driven by equity inflows (80 per cent of total flows) which remained buoyant, indicating FII confidence in the performance of the Indian economy in general and Indian markets in particular. The economic and political developments in the *Euro zone area* and *United States* had their impact on markets around the world including India. The resolution of the **fiscal cliff**[11] in the US had a positive impact on the market worldwide including in

India. Further, reform measures recently initiated by the government have been well received by the markets.

New Rules for Foreign Investment

To promote the flow of foreign funds into the economy the RBI, on *January 24, 2013,* further liberalised the provisions of investment in India's security market –

- FIIs and ***long-term investors***[12] investment limit in Government Securities (G-Secs) enhanced by US $5 billion (to US $ 25 b).
- Investment limit in corporate bonds by the above-given entities enhanced by $5 billion (to $50 billion).
- The RBI also relaxed some investment rules by removing the maturity restrictions for first time foreign investors on dated G-Secs (earlier a three–year residual maturity was must for first time foreign investors). But such investments will not be allowed in short-term paper like Treasury Bills.
- Foreign investors restricted from investing in the 'money market' instruments – certificates of deposits (CDs) and commercial paper (CPs).
- In the total corporate debt limit of $50 billion, a sub-limit of $25 billion each for infrastructure and other than infrastructure sector bonds has been fixed.
- Rules requiring FIIs to hold infrastructure debt for at least one year has been abolished.
- The qualified foreign investors (QFIs) would continue to be eligible to invest in *corporate debt securities* (without any lock-in or residual maturity clause) and *mutual fund debt schemes*, subject to a total overall ceiling of $1 billion (this limit of $1 billion shall continue to be over and above the revised limit of $50 billion for investment in corporate debt).
- As a measure of further relaxation, it has been decided to dispense with the condition of one year lock-in period for the limit of $22 billion (comprising the limits of infrastructure bonds of $12 billion and $10 billion for non-resident investment in IDFs) within the overall limit of $25 billion for foreign investment in infrastructure corporate bond.
- The residual maturity period (at the time of first purchase) requirement for the entire limit of $22 billion for foreign investment in the infrastructure sector has been uniformly kept at 15 months. The five-year residual maturity requirement for investments by QFIs within the $3 billion limit has been modified to three years original maturity.

ANGEL INVESTOR

A new term in India's financial market, introduced in the ***Union Budget 2013-14*** which announced that SEBI will soon prescribe the provisions by which the **angel investor** can be recognised as *Category I AIF*[13] *venture capital funds.*

Angel investor is an investor who provides financial backing to entrepreneurs for 'starting their business'. Angel investors are usually found among an entrepreneur's family and friends but they may be from outside also. The capital they provide can be a one-time injection of seed money or ongoing

support to carry the company through difficult times – in exchange they may like owning share in the business or provide capital as loan (in case of a loan they lend at more favorable terms than other lenders, as they are usually investing in the *person* rather than the viability of the business). Other than investible capital, these investors provide technical advices and also help the 'start-up' business with their lucrative contacts.

They are focused on helping the business succeed, rather than reaping a huge profit from their investment. Angel investors are essentially the *exact opposite* of a venture capitalist in their 'intention' (who has high profit prospects as their prime focus). But in one sense both – an *angel investor* and a *venture investor*–serve the same purpose for the entrepreneur (who is in dire need of investible capital).

QFIs SCHEME

In Budget 2011-12, the government, for the first time, permitted qualified foreign investors (QFIs), who meet the know-your-customer (KYC) norms, to invest directly in Indian mutual funds. In January 2012, the government expanded this scheme to allow QFIs to directly invest in Indian equity markets. Taking the scheme forward, as announced in *Budget 2012-13*, QFIs have also been permitted to invest in corporate debt securities (CDSs) and MF debt schemes subject to a total overall ceiling of US $ 1 billion.

In *May 2012*, QFIs were allowed to open individual non–interest-bearing rupee bank accounts with authorized dealer banks in India for receiving funds and making payment for transactions in securities they are eligible to invest in. In *June 2012*, the definition of QFI was expanded to include residents of the member countries of the Gulf Cooperation Council (GCC) and European Commission (EC) as the GCC and EC are members of the Financial Action Task Force (FATF).

The speedier moves in the area of promoting higher foreign investment (FIs) in India should be seen in the light of two broad perspectives –

(i) India's rising current account deficit (which crossed an all-time high of 6.7 per cent by *March 2013*) which is creating heavy drain of foreign exchange; and

(ii) The objective of attracting more FIs while the Western economies are under the spell of recession (cashing in the opprtunity).

PARTICIPATORY NOTES (PNs)

A Participatory Note (PN or P-Note) in the Indian context, in essence, is a *derivative* instrument issued in foreign jurisdictions, by a SEBI registered Foreign Institutional Investor (FII), against Indian securities – the Indian security instrument may be equity, debt, derivatives or may even be an index. PNs are also known as *Overseas Derivative Instruments*, *Equity Linked Notes*, *Capped Return Notes,* and *Participating Return Notes*, etc.

The investor in PN does not own the underlying Indian security, which is held by the FII who issues the PN. Thus, the investors in PNs derive the economic benefits of investing in the security without

actually holding it. They benefit from fluctuations in the price of the underlying security since the value of the PN is linked with the value of the underlying Indian security. The PN holder also does not enjoy any voting rights in relation to security/shares referenced by the PN.

Reasons for the popularity of PNs

The reasons why PNs became such a popular ruote for foreign investors to invest in the India security market may be understood through the following points:

- One of the primary reasons for the emergence of the PN (an 'off-shore derivative instrument', i.e., an ODI) is the restrictions on foreign investments. For example, a foreign investor intending to make portfolio investments in India was required to seek FII registration for which he is required to meet certain eligibility criteria. Lack of full *Capital Account Convertibility* further enhances the entry barriers from the perspective of a foreign investor. However, Since *January 2012*, The Indian government has taken a decision to give direct access to such prospective 'foreign individual investors' who were hitherto banned to invest in equity of Indian companies.
- The off-shore derivative market allows investors to gain exposure to the local shares without incurring the time and costs involved in investing directly. In return, the foreign investor pays the PN issuer a certain basis *point(s)* of the value of PNs traded by him as *costs*. For instance, directly investing in the Indian securities markets as an FII, has significant cost and time implications for the foreign investor. Apart from seeking FII registration, he is required to establish a domestic broker relationship, a custodian bank relationship, deal in foreign exchange and bear exchange rate fluctuation risk, pay domestic taxes and/or filing tax return, obtain or maintain an investment identity etc. These investors would rather look for derivatives alternatives to gain a cost-effective exposure to the relevant market.
- Besides reducing transactions costs, PNs also provide customized tools to manage risk, lower financing costs and enhance portfolio yields. For instance, PNs can also be designed for longer maturities than are generally available for exchange-traded derivative.
- PNs also offer an important *hedging tool* to a foreign investor already registered as an FII. For example; an FII may wish to obtain 'long' exposure to a particular Indian security. The FII can hedge the downside exposure to the listed security, already purchased by purchasing a 'cash settled put option'. Although the Indian exchanges offer options contract, these contracts have a maximum life period of three months, beyond which the FII shall have to rollover its positions i.e. purchase a fresh option contract. Alternatively, it can avail of a PN which can be customized to cater to its hedging requirements.
- Potential investors who would like to take direct Indian exposure in future, may make initial investments through the PN route so as to get a flavor of future anticipated returns.
- Further, trading in ODI/PNs gives an opportunity to offshore entities to have a commission based business model. This route provides ease to subscribers as it bypasses the direct route which may be resource heavy for them.
- And ***lastly***, it was a highly 'safe and lucrative route' to invest the 'unaccounted', 'even illegal' money into the Indian security market for huge profits (during the booming market).

Experts even imagined that it may be allowing the 'black money' of India (stashed away from India through 'hawala' kind of illegal channels and deposited in the tax havens of the world in 'Swiss Bank' kind of financial institutions) to get invested back in the market! Again, 'terrorist organisations' might have been using this route, too.

PNs are ***thus*** issued, to provide access to a set of foreign investors who intend to reduce their overall costs and the time involved in making investments in India. In other words, the attraction of investing in PNs is primarily one of efficiency (from an infrastructure and time perspective) for which they are willing to forego certain benefits of directly holding the local securities (fro example, title and voting rights) whilst also assuming other risks.

Regulation of PNs

PNs are market instruments that are created and traded overseas. Hence, Indian regulators cannot ban the issue of PNs. However, they can regulated, as SEBI does – when a PN is traded on an overseas exchange, the regulator in that jurisdiction would be the authority to regulate that trade. Participatory notes have been used by FIIs since FIIs were permitted to invest in the securities market (1994) – they were not specifically dealt with under the regulations until 2003. According to the *SEBI Regulation, 2004* (and further amended in 2008) with the ***objective*** of tightening regulations in this regard –

(i) PNs can be issued only to those entities which are regulated by the relevant regulatory authority in countries of their incorporation and are subject to compliance of 'know your client' (KYC) norms.

(ii) Down-stream issuance or transfer of the instruments can also be made only to a regulated entity.

(iii) Further, the FIIs who issue PNs against underlying Indian securities are required to *report* the issued and outstanding PNs to SEBI in a prescribed format.

(iv) In addition, SEBI can call for any information from FIIs concerning off-shore derivative instruments (ODIs) issued by it.

(v) In order to monitor the investment through these instruments, SEBI on *October 31, 2001*, advised FIIs to submit information regarding issuance of derivative instruments by them, on a monthly basis. These reports require the communication of details such as name and constitution of the subscribers to PNs, their location, nature of Indian underlying securities etc.

(vi) FIIs cannot issue PNs to non-resident Indians (NRIs) and those issuing PNs are required to give an undertaking to the effect.

(vii) SEBI has also mandated that QFIs (qualified foreign investors), the recently allowed foreign investor class, shall not issue PNs.

SEBI in consultation with the Government had decided in *October 2007*, to place certain restrictions on the issue of PNs by FIIs and their sub-accounts. This decision was taken with a view to moderate the surge in foreign capital inflows into the country and to address the 'know-your-client' concerns for PN holders. However, it was found that such restrictions were ineffective. Therefore, SEBI in October 2008 reviewed its earlier decision and decided to remove these restrictions in the light of the above factors. Rather, more attention is given to effective disclosures.

The Concerns related to PNs

Being derivative instruments and freely tradable, PNs can be easily transferred, creating multiple layers, thereby obfuscating the real beneficial owner. It is in this respect that concerns about the ***identity of ultimate beneficial*** owner and the source of funds arises.

For the reason that such instruments are issued outside of India, these transactions are outside the purview of SEBI's surveillance and it is the FII which acts as mini-exchange overseas. The actual transactions in the underlying securities are executed by the FIIs only at its discretion, as and when necessary and there is no one-to-one correspondence between transactions in the underlying instruments and issuance of PNs.

The ex-post reporting requirement enjoined upon the FII in respect of PNs on a monthly basis effectively keeps the transactions in PNs out of the real time market surveillance mechanism and beyond the enforceability jurisdiction of SEBI.

There are also concerns that some of the money coming into the market via PNs could be the ***'unaccounted wealth'*** camouflaged under the guise of FII investment. However, this has not been proved so far. SEBI has indeed been successful in taking action against the FIIs who were non-compliant and those who had misreported offshore derivatives [as happened when SEBI took actions against two FIIs – *Barclays* in December 2009 and *Societe Generale* in January 2010]

At present, PNs are issued by large financial sector conglomerates which not only have strong presence in the global investment banking arena but also have asset management arms which invest across a number of securities markets globally. These entities are originally incorporated in well-regulated and developed jurisdictions like the US, UK etc. Further, these entities also possess the financial wherewithal to issue PNs, complemented by skilled personnel who are adept at risk management and financial engineering activities.

International Situation

PN like products are not necessarily used to invest in restricted markets but also reported to be available in the open developed/advanced economies like Japan, Hong Kong, Singapore, Australia, the USA and UK. In response to market manipulation concerns, in December 1999, *Taiwan Securities and Futures Commission* had amended its FII regulations to require periodic disclosure by FIIs of all offshore derivative activities linked to local shares, but this requirement was subsequently removed in June 2000 (as the Ashok Lahiri Committee Report says). *China*' s *Securities Regulatory Commission* requires entities to file reports related to these products with minimal 'reporting requirements that emphasize only on the quota utilized by them'. *Other Asian countries* like Hong Kong, Singapore and Japan have reportedly 'no restrictions' or requirements on PNs. Malaysia, Indonesia and Philippines which are restricted markets though, are having no reporting requirements in this regard.

Hedge Fund

This term has come up from another term ***hedging***, a process by which businesses insulate themselves from the risk of price changes.[14] Hedge funds are the lot of investible (free floating capital) capital

which move very swiftly towards the more profitable sectors of an economy.

At present, such funds easily move from the stock market of one economy to the other—away from the low profit fetching to high profit fetching ones. As stock markets fall and rise such funds change markets accordingly. By nature they are temporary. The period for which they continue flowing into an economy there is naturally a boom time. But when they quit for a more attractive economy, the same economy might not be able to manage the accelerated foreign currency outflow and there are chances of imminent foreign currency crisis. This has been in news for the last two years in India where stock market has been in boom, riding on the FIIs inflow via Participatory Notes (PNs).

SHORT SELLING

Sale of a share which is not owned. This is done by someone after borrowing shares from stockbrokers promising to replace them at a future date on the hope (speculation) that the price will fall by then. He fetches profit if price of the share really fell down by the future date of replacement and sustains a loss if the price increased. Recently, short selling has been allowed in India by SEBI.

Bear and Bull

A person who speculates share prices to fall in future and so sells his shares and earns profit is a *bear*. He earns profit out of a falling market. Basically, here he is short selling the shares.

Opposite to bear, bull is a person who speculates share prices to go up in future so either stops selling the select group of shares for that time to be reached (he is basically taking long position on those shares) or starts purchasing that select group of shares.

Thus, a bear increases the number of shares in a stock market activating a general fall in the index—a bearish market. Opposite to it, a bull creates a scarcity of shares in the stock market activating a general rise in the share prices and the index—a bullish market.

Brokers play as a bear for some stocks and as a bull for some other stocks. While a bear broker is a non-entity, a bull is remembered for long time to come—Harshad Mehta was known as the Great Bull.

Book Building

A provision allowed by the SEBI to all Initial Public Offers (IPOs) in which individual investors are reserved and allotted shares by the company. But the issuer has to disclose the price (at which shares have been allotted the size of the issue and the number of shares offered to the public).

IPO

Initial Public Offer (IPO) is an event of share issuing when a company comes up with its share/securities issued for the first time.

Price Band

A process of public issue where the company gives a price range (known as price band) and it is left upon the share applicants to quote their prices on it—the highest bidders getting the shares. This is a variant of share issue at premium but considered a safer choice.

ECB Policy

A prospective borrower can access external commercial borrowings (ECBs) under two routes, namely the 'automatic route' and the 'approval route'. ECBs not covered under the automatic route are considered on case-by-case basis by the RBI under the approval route. The High Level Committee on ECB took a number of decisions in *September 2011* to expand the scope of ECBs which include:

(i) High networth individuals (HNIs) who fulfil the criteria prescribed by SEBI can invest in IDFs.

(ii) IFCs have been included as eligible issuers for FII investment in the corporate bonds long-term infra category.

(iii) ECB would be permitted for refinancing of rupee loans of infrastructure projects on the condition that at least 25 per cent of such ECBs shall be used for repayment of the said rupee loan and 75 per cent invested in new projects in the infrastructure sector (but only under the approval route).

(iv) Refinancing of buyer's/supplier's credit through ECBs for the purchase of capital goods by companies in the infrastructure sector was approved. This would also be permitted only under the approval route.

(v) ECBs for interest during construction (IDC) that accumulates on a loan during the project execution phase for companies in the infrastructure sector would be permitted. This would be subject to the condition that the IDC is capitalised and is part of the project cost.

(vi) Renminbi (RMB) – the Chinese currency – was approved as an ***acceptable currency*** for raising ECBs subject to/limit of US $ 1 billion within the existing ECB ceiling (allowed only through the approval route).

(vii) The existing ***ECB limits*** under the automatic route were enhanced from US $ 500 million to US$ 750 million for eligible corporates. For borrowers in the *services sector,* the limit has been enhanced from US$ 100 million to US$ 200 million and for *NGOs* engaged in *micro-finance* activities from the existing US$ 5 million to US$ 10 million.

(viii)INR (rupee) denominated ECBs would be permitted from foreign equity holders to 'all eligible borrowers' except in the case of ECBs availed of by NGOs under the automatic route.

During the financial year ***2012-13*** the external commercial borrowings (ECB) policy was further liberalized via the following steps –

- Enhancing the limit for refinancing rupee loans through ECB from 25 per cent to 40 per cent for Indian companies in the power sector;
- Allowing ECB for capital expenditure on the maintenance and operation of toll systems for roads and highways so long as they are a part of the original project subject to certain

conditions, and also for low cost housing projects;

- Reducing the withholding tax from 20 per cent to 5 per cent for a period of three years (July 2012 - June 2015) on interest payments on ECBs;
- Introducing a new ECB scheme of US $10 billion for companies in the manufacturing and infrastructure sectors;
- Permitting the Small Industries Development Bank (SIDBI) as an eligible borrower for accessing ECB for on-lending to the micro, small, and medium enterprises (MSMEs); and
- Permitting the National Housing Bank (NHB)/Housing Finance Companies to avail themselves of ECBs for financing prospective owners of low cost /affordable housing units.

RGESS

On *November 23, 2012*, the government notified a new tax saving scheme called the Rajiv Gandhi Equity Savings Scheme (RGESS), ***exclusively for first-time retail investors*** in the securities market. This scheme provides 50 per cent deduction of the amount invested from taxable income for that year to new investors who invest up to Rs. 50,000 and whose annual income is below Rs. 10 lakh.The Rajiv Gandhi Equity Saving Scheme (RGESS) will give tax benefits to new investors whose annual income is up to Rs. 10 lakh for investments up to a maximum of Rs. 50,000. The investor will get 50 per cent deduction of the amount invested from taxable income for that year. Salient features of the scheme are as follows –

- The scheme is open to new retail investors identified on the basis of their permanent account numbers (PAN).
- The tax deduction allowed will be over and above the Rs. 1 lakh limit permitted allowed under Section 80 C of the IncomeTax Act.
- In addition to the 50 per cent tax deduction for investments, dividend income is also tax free.
- Stocks listed under BSE 100 or CNX 100, or stocks of public-sector undertakings (PSUs) that are Navratnas, Maharatnas, and Miniratnas will be eligible under the scheme. Follow-on public offers (FPOs) of these companies will also be eligible.
- IPOs of PSUs, which are scheduled to get listed in the relevant financial year and whose annual turnover is not less than Rs. 4,000 crore for each of the immediate past three years, will also be eligible.
- Exchange-traded funds (ETFs) and MFs that have RGESS-eligible securities have also been brought under the RGESS.
- To benefit small investors, investments are allowed in instalments in the year in which tax claims are made.
- The total lock-in period for investments will be three years including an initial blanket lock-in of one year. After the first year, investors will be allowed to trade in the securities.

The broad provisions of the scheme and the income tax benefits under it have already been incorporated as a new *Section-80CCG* of the Income Tax Act 1961, as amended by the Finance Act 2012. The operational guidelines were issued by SEBI on *December 6, 2012*.

CREDIT DEFAULT SWAP (CDS)

CDS is in operation in India since October 2011 – launched in only corporate bonds. The eligible participants are commercial banks, primary dealers, NBFCs, insurance companies and mutual funds.

CDS is a credit derivative transaction in which two parties enter into an agreement, whereby one party (called as the 'protection buyer') pays the other party (called as the 'Protection Seller') periodic payments for the specified life of the agreement. The protection seller makes no payment unless a credit event relating to a pre-determined reference asset occurs. If such an event occurs, it triggers the Protection Seller's settlement obligation, which can be either cash or physical (India follows physical settlement). It means, ***CDS is a credit derivative that can be used to transfer credit risk from the investor exposed to the risk*** (called protection buyer) ***to an investor willing to take risk*** (called protection seller).

It operates like an insurance policy. In an insurance policy, the insurance firm pays the loss amount to the insured party. Similarly, the buyer of the CDS – the bank or institution that has invested in a corporate bond issue – seeks to mitigate the losses it may suffer on account of a default by the bond issuer. Credit default swaps allow one party to 'buy' protection from another party for losses that might be incurred as a result of default by a specified reference instrument (a bond issue in India). The 'buyer' of protection pays a premium to the seller, and the 'seller' of protection agrees to compensate the buyer for losses incurred upon the occurrence of any one of the several specified 'credit events'. *Thus CDS offers the buyer a chance to transfer the credit risk of financial assets to the seller without actually transferring ownership of the assets themselves.*

Let us try to understand it by an example – suppose Punjab National Bank (PNB) invests in Rs. 150 crore bond issued by TISCO. If PNB wishes to *hedge* losses that may arise from a default of TISCO, then PNB may buy a credit default swap from a financial institute, suppose, Templeton. PNB will pay fixed periodic payments to Templeton, in exchange for default protection (just like premium of an insurance policy).

CDS can be *used for different purposes* in a financial system –

(i) Protection buyers can use it to hedge their credit exposure while protection sellers can use it to participate in credit markets, without actually owning assets.

(ii) The protection buyer can transfer credit risk on an entity without transferring the under lying instrument, reap regular benefit in terms of lower capital charge, seek reduction of specific concentrations in credit portfolio and go short on credit risk.

(iii) The protection seller will be able to diversify his portfolio, create exposure to a particular credit, have access to an asset which may not otherwise be available, and increase the yield on his portfolio.

(iv) Banks can use it to transfer risk to other risk takers, create capital for more lending.

(v) Distribute risk widely throughout the system and prevent concentrations of risk.

Some analysts have serious **apprehensions** about CDS. *George Akerlof*, Nobel prize-winning economist, in 1993, predicted that the next meltdown will be caused by CDS. In 2003 investment legend *Warren Buffet* called them as 'weapons of mass destruction'. The former US Federal Reserve

Chairman *Alan Greenspan*, who betted big on CDS said after the 'sub prime' crisis that 'CDS are dangerous'. A leading US weekly the *Newsweek* described CDS, 'the monster that ate Wall Street'. Many Indian experts had the opinion that 'CDS will not stabilize the economy rather could lead to destabilization'.

CDS contract are dangerous because they can be manipulated for mischief. It's all about the insurable interest which is never there as it is used for *speculation*. A derivative that amounts to an insurance contract with no insurable interest is bad. But do the speculators have insurable interest? No they don't have any! The US 'sub prime' crisis was a fallout of such CDS contracts – one defaulting and another claiming the 'protection' finally resulting into the defaulter of the insuring company – overnight the biggest US insurance giant, AIG went bankrupt. So happened with many US banks also.

The most damaging aspect of CDS is that the credit risk of one country/region gets exported to another country/region very smoothly and silently – thus there is a serious chance of 'contagion effect' suppose there are defaulters there – the thing which happened during the US 'sub prime' crisis.

SECURITISATION

This is the process of issuing 'marketable securities' backed by a pool of existing assets such as auto or home loans. After an asset is converted into a marketable security, it is sold to an investor who then receives interest and principal out of the cash flow generated from servicing of the loan. Financial institutions such as NBFCs and microfinance companies convert their loans into marketable securities and sell them to investors. This helps them get liquid cash out of assets that otherwise would be stuck on their balance sheets.

Global experience shows that if the value of the underlying asset falls then securitised assets lose value as it had happened during the US 'sub-prime crisis' – home loans against which securitised assets were sold to insurance companies and banks lost value, which in turn resulted in a crisis. To prevent such crises, the RBI has taken some precautionary steps in this regard – it has asked companies to hold securities for a certain minimum period:

(i) While NBFCs need to keep assets for six months – a minimum retention requirement of 5-10 per cent to ensure that they have a continuing stake in the performance of securitised assets.

(ii) Micro Finance Institutions (MFIs) need to hold them for three months.

Since it was allowed in India by the RBI, it has been in news – whether the 'securitisations trusts' will need to pay tax on it. Meanwhile, the *Union Budget 2013-14* has cleared the air on the issue – there should not be any additional income-tax if the income distributed by the trust is received by a person who is exempted from tax. This is expected to bring back mutual fundss into the securitisation market.

CORPORATE BOND IN INDIA

Economic vibrancy coupled with sophisticated state–of–the–art financial infrastructure has contributed to rapid growth in the equity market in India. In terms of market features and depth, the

Indian equity market ranks among the best in the world. In parallel, the government securities market has also evolved over the years and expanded, given the increasing borrowing requirements of the government. In contrast, the corporate bond market has languished both in terms of market participation and structure. Non-bank finance companies are the main issuers and very small amounts of finance are raised by companies directly. The ***Economic Survey 2010-11*** (p.116), cites many reasons for the less-developed bond market in India –

(i) Predominance of banks loans;
(ii) FII's participation is limited;
(iii) Pensions and insurance companies and household are limited participants because of lack of investor confidence; and
(iv) Crowding out by Government bonds.

The ***Economic Survey 2011-12*** concluded[15] that there is now ample empirical research to corroborate Schumpeter's conjecture that financial development facilitates real economic growth. The depth of the financial markets and availability of diverse products should, therefore, not be treated as mere adornment but as critical ingredients of inclusive growth.

Banks in India accounted for 14.4 per cent of the financing of large firms in 2000-01, which rose further to 17.8 per cent in 2010-11. The *bond market*, on the other hand, has been miniscule in comparison. The thinness of the bond market has been somewhat compensated by foreign borrowing done by Indians, which rose sharply over the last decade. Further, India is characterized by a disproportionate amount of secured borrowing. The small size of unsecured borrowing may, at first sight, not seem to be a matter of concern, but it could be a reflection of the weakness of contract enforcement and lack of adequate information. If contracts were quickly enforced and lenders had information on borrowers, they would be more willing to give unsecured loans. This would give a nimbleness to the financial markets which they presently lack.

There are ***many reasons*** why bond markets are important for an emerging economy. Prominent among these is the fact that they lead to more efficient entrepreneurship and greater value creation. When an entrepreneur takes a loan or issues bonds, all additional profit over and above the pre-fixed repayment amount accrues to the entrepreneur. So he or she is better incentivized to take sharper decisions. By having a weak bond market, we may be foregoing this efficiency. And further, this efficiency gap may well mean that there is less lending and hence less investment and entrepreneurship in the economy than is feasible. Further, as India tries to garner 500 billion dollars from the private sector in the Twelfth Plan for investment in the infrastructure sector, having an active bond market would be a valuable avenue for raising money.

There can be many reasons why, despite these advantages, the bond market has not developed adequately. One reason has to do with what economists call 'multiple equilibria'. Consider a situation where the bond market is small. If someone buys bonds and later wish to sell these off, he anticipates difficulty. Since the bond market is not active, he may not easily be able to sell the bonds and thus he will hold simply because he cannot find a buyer. Hence, this may lead to discourage someone from buying the bonds in the first place. If everybody reasons like this, the bond market remains thin. Hence, the need is for a push that nudges the market to another equilibrium, where people readily buy bonds because they know that they can easily sell these off and this becomes a self-fulfilling prophesy and sustains the large bond market.

There is effort currently on to try to boost India's debt and bond markets and success in this can give another fillip to growth. With the intervention of the ***Patil Committee*** recommendations, the corporate bond market is slowly evolving. With bank finance drying up for long term infrastructure projects, in view of asset liability problems faced by the banking system, the need for further development of a deep and vibrant corporate bond market can hardly be overemphasised. Recent initiatives for further development of corporate bond markets, taken in the year ***2012-13*** are as given below –

- Banks allowed to take limited membership in SEBI-approved stock exchanges for the purpose of undertaking proprietary transactions in the corporate bond markets.
- To enhance liquidity in the corporate bond markets, the IRDA has permitted insurance companies to participate in the repo market. The IRDA has also permitted insurance companies to become users of '*credit default swap*' (CDS).
- The minimum **haircut**[16] (i.e. the difference between prices at which a market maker can buy and sell a security) requirement in corporate debt repo have been reduced from the existing 10 per cent; 12 per cent; 15 per cent to 7.5 per cent; 8.5 per cent; 10 per cent for AAA/AA+/AA- rated corporate bonds.
- MFs have been permitted to participate in CDS in corporate debt securities, as users.
- Revised guidelines on CDS for corporate bonds by the RBI provide that in addition to listed corporate bonds, CDS shall also be permitted on *unlisted* but rated corporate bonds even for issues other than infrastructure companies.
- Users shall be allowed to **unwind**[17] their CDS-bought position with the original protection seller at a mutually agreeable or FIMMDA (Fixed Income Money Market and Derivatives Association of India) price. If no agreement is reached, then unwinding has to be done with the original protection seller at FIMMDA price.
- CDS shall be permitted on securities with original maturity up to *one year* like CPs, certificates of deposit, and non-convertible debentures with original maturity less than one year.

Economic Survey 2012-13 comments: A reasonably well-developed corporate bond market is very much required in any economy to supplement banking credit and the equity market and to facilitate the long-term funding requirement of corporate sector as well as infrastructure development in the country. Though, the development of the corporate bond market has been an important area and has received greater policy attention in recent times, it is yet to take off in a significant manner. Some of the issues that ***need to be addressed*** in this regard include:

- Drawing up a roadmap for a structural shift from a *bank-dominated* financial system to a more diverse financial system where top-rated corporates access finance from capital markets;
- Strengthening of the *legal framework* for regulation of corporate debt by necessary amendments in rules/regulations, and
- Relaxation of investment *guidelines* for pension, provident, and insurance funds to enable the participation of longterm investors in the corporate bond market.

Introduction of new products and making nascent products such as covered bonds, municipal bonds, credit default swaps, credit enhancements, and securitization receipts more attractive may be considered for public issuance of bonds at reduced cost. Improving the market infrastructure for enabling liquidity, transparency in price discovery, and stimulating growth in trading volumes also need to be suitably addressed.

Inflation-Indexed Bonds

To protect the returns of investors from the vagaries of inflation, the Reserve Bank of India plans to introduce inflation-indexed bonds (IIBs) – it was proposed by the ***Union Budget 2013-14***. The government hopes this will help increase *financial savings instead of buying gold*. In the recent years, the rate of return on debt investments has often been below inflation, which effectively means that inflation was eroding savings. Inflation indexed bonds provide returns that are always in excess of inflation, ensuring that price rise does not erode the value of savings. The Bond waslaunched in June, 2013.

Gold Exchnage Traded Funds

Gold Exchange Traded Funds (ETFs) are *open-ended mutual fund schemes* that closely track the price of physical gold. Each unit represents *one gram* of gold having 0.995 purity, and the ETF is listed on stock exchanges. The net asset value of each unit is calculated based on the prices of physical gold prevailing on that day and is designed to provide returns that would closely track the returns from physical gold.

Gold ETFs have seen net outflows in *March 2013* and in the first fortnight of *April 2013* with investors turning net sellers ***due to falling prices*** of gold in global markets.

e-Gold

e-Gold is another purchase option, involving investments in units traded on the National Stock Exchange (NSEL). Here, the investor is required to have a demat account with an affiliate of NSEL. e-Gold's brokerage and transaction charges are lower than *gold ETFs* as there are no fund management charges. One can take delivery of gold or sell it in the exchange.

But there is also a *negative point* here from the tax angle – under e-Gold, one has to hold the yellow metal for 36 months to enjoy *long-term capital gain* benefits, and this is taxed at 20 per cent. For ETFs (Exchange Traded Funds) and gold funds, the holding period to be classified as long-term is only one year. After a year, ETF and gold funds will suffer 10 per cent tax without indexation and 20 per cent after indexation. For a small investor, gold ETF would appear to be the best option, as it meets his needs without difficulties in terms of creating a separate demat account, tax implications and wealth tax.

PENSION SECTOR REFORMS

Pension has been the integral part of government jobs in India. Pension serves two important soci-

economic objectives –

(i) It facilitates the flow of long-term savings for development, i.e., *nation-building*; and

(ii) Also helps establish a credible and sustainable *social security system* in the country.

The New Pension System (NPS) was introduced for the new recruits who join government service on or after ***January 1, 2004***. Although the NPS is perhaps one of the cheapest financial products available in the country, in order to make it affordable for the economically disadvantaged, the government in September 2010 introduced a lower cost version, known as ***Swavalamban Scheme***, which enables groups of people to join the NPS at a substantially reduced cost. As per existing scheme under NPS, Swavalamban could be availed either in 'unorganised sector' or in ***'NPS Lite'***. NPS Lite is a model specifically designed to bring NPS within easy reach of the economically disadvantaged sections of the society – it is extremely affordable and viable due to its optimised functionalities, available at reduced charges. Under the Swavalamban scheme, the government provides subsidy to each NPS account holder and the scheme has been extended until 2016-17.

A customised version of the core NPS model, known as the *NPS Corporate Sector Model* was also introduced from December 2011 to enable 'organised-sector' entities to move their existing and prospective employees to the NPS under its Corporate Model. All the pubic sector banks have been asked to provide a link on their website to enable individual subscribers to open online NPS accounts.

As per the ***Economic Survey 2012-13,*** the pension reforms in India have generated widespread interest internationally but before universal inclusion of poorer sections of Indian society into the pension network is a reality, the economy needs to solve the following *major challenges* –

(i) Lower levels of financial literacy, particularly among workers in the unorganised sector;

(ii) Non-availability of even moderate surplus;

(iii) Lukewarm response so far from most of the State/UT governments to a co-contributory Swavalamban Scheme; and

(iv) The lack of awareness, on the supply side, about the NPS and of access points for people to open their accounts individually have been major inhibiting factors.

Financial Stability and Development Council (FSDC)

An apex level Financial Stability and Development Council (FSDC) was set up by the GoI in December 2010, 'in line with the G–20 initiatives' with the following ***objectives***:

(i) to strengthen and institutionalise the mechanism for maintaining financial stability,

(ii) to enhance inter-regulatory coordination, and

(iii) to promote financial-sector development.

The Council is *chaired* by the Finance Minister and has *heads* of financial-sector regulatory authorities, the Finance Secretary and/or Secretary of the Department of Economic Affairs, Secretary of the Department of Financial Services, and the Chief Economic Adviser as members. Without prejudice to the autonomy of regulators, the Council ***monitors*** –

(i) macro-prudential supervision of the economy, including functioning of large financial conglomerates,

(ii) inter-regulatory coordination and financial-sector development issues, and
(iii) *financial literacy* and *financial inclusion*.

Financial Sector Assessment Programme (FSAP)

The *IMF Board* decided in September 2010, to include 25 *systemically* important economies, including India, under the Financial Stability Assessment Programme (FSAP) for members with systemically important financial sectors. The joint IMF-World Bank Financial Stability Assessment Programme (FSAP) was conducted for India in *January 2013* which assessed Indian financial system in relation to the highest international standards. The **assessment** recognises that the Indian financial system remained *largely stable* on account of a sound regulatory and supervisory regime. However, the assessment identifies *some gaps* in[18] –

(i) International and domestic supervisory information sharing and co-operation;
(ii) Consolidated supervision of financial conglomerates; and
(iii) Some limits on the *de jure* independence of the regulators (RBI and IRDA).

Despite having reservations on a few issues, overall the Indian authorities expect the FSAP exercise to play a *significant role* in shaping India's post-crisis initiatives to strengthen the regulatory and supervisory architecture based on the evolving international consensus as well as careful examination of their relevance in the India-specific context. As a member of the FSB[19], BCBS[20] and IMF[21], India is actively participating in post-crisis reforms of the international regulatory and supervisory framework under the aegis of the **G20**. India remains committed to adoption of international standards and best practices, in a phased manner and calibrated to local conditions, wherever necessary, as it is a country characterised by complex and diverse socio-political and economic conditions.

Financial Stability and Development Council (FSDC)

As a follow-up to the announcement made in the Budget 2010–11, with the ***objective*** to strengthening and institutionalising the mechanism for maintaining financial stability and enhancing inter-regulatory coordination, an apex-level Financial Stability and Development Council under the Chairmanship of the Finance Minister has been set up.

A sub-committee of the FSDC has also been set up under the chairmanship of the Governor RBI. Under the aegis of the FSDC, two empowered Technical Groups (i.e., Technical Group on Financial Literacy and Financial Inclusion and Inter-Regulatory Technical Group) have been formed.

Financial Sector Legislative Reforms Commission (FSLRC)

Fulfilling the announcement of the Budget of 2010–11, to ***rewrite*** and ***harmonise*** financial sector legislations, rules and regulations the GoI constituted the FSLRC under the chairmanship of Justice (Retd.) B. N. Srikrishna in March 2011 (tenure is 2 years). This had become necessary as the institutional framework governing India's financial sector was built over a century.

There are over 60 Acts and multiple Rules/Regulations in the sector and many of them are decades old, when the financial landscape was very different from what it is obtaining today. Large number of amendments made in in these Acts over time has increased the *ambiguity* and *complexity* of the

system.

The Commission would simplify and re–write financial sector legislations, including subordinate legislations, to bring them in line with the requirements of the sector to achieve harmony and synergy among them, making them more coherent and dynamic and help cater to the requirements of a large and fast growing economy in tune with the changing financial landscape in an inter-connected financial world. In the long-term, it would help usher in the *next generation of reforms,* contribute to efficient financial intermediation enhancing the growth potential of the nation. The Commission handed over its report end-March 2013 (see Chapter 11 sub-topic 'Financial Regulators').

Financial Action Task Force (FATF)

The FATF is an inter-governmental policymaking body that has a ministerial mandate to establish international standards for combating *money laundering* and *terrorist financing.* India joined the FATF as its 34th member in June 2010. At present, the FATF has 36 members comprising 34 countries and two organisations (European Union and Gulf Cooperation Council).

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1. Marc Levinson, ***Guide to Financial Markets,*** The Economist, London, 2006, p. 152.
2. V. Raghunathan, ***Stock Exchanges and Investments,*** Tata McGraw-Hill, N. Delhi, 1994, p. 4.
3. Marc Levinson, 2006, op. cit., pp. 153–54; Ministry of Finance, ***Economic Survey 2005–06,*** GoI, N. Delhi.
4. MoF, GoI, dated 22 April, 2013.
5. This section is based on various sources – the, SEBI, NSE, BSE, 'World Federation of Exchanges', select issues of *The Economist* and news reportings of *The HT Live Mint, The Business Line and The Economic Times.*
6. P. Chidambaram while presenting the ***Union Budget 2006–07,*** N. Delhi.
7. Surendra Sundararajan, ***Book of Financial Terms,*** Tata Mc Graw-Hill, N.Delhi, 2004, p. 117.
8. Tim Hindle, op. cit., p. 129.
9. Surender Sundararajan, op. cit., p. 134.
10. As per the latest ***Economic Survey 2012-13****,* op. cit., p. 121.
11. **'Fiscal cliff'** is a term used to describe the crisis that the US government faced at the end of 2012, when the terms of the Budget Control Act of 2011 were scheduled to go into effect – a combination of – i). expiring tax cuts and ii). across-the-board government spending cuts scheduled to become effective December 31, 2012. The idea behind the fiscal cliff was that if the federal government allowed *these two* events to proceed as planned, they would have a detrimental effect on an already shaky economy, perhaps sending it back into an official *recession* as it cut household incomes, increased unemployment rates and undermined consumer and investor confidence [As per the conservative estimates by some US experts, it would have meant a tax increase to the size of which the country had never seen in the last in 60 years].

    Who did first use the term is not clear – some believe that it was first used by Goldman Sachs economist, *Alec Phillips*, while some others credit Federal Reserve Chairman *Ben Bernanke*, still others credit *Safir Ahmed*, a reporter for the *St. Louis Post-Dispatch*, who in 1989 used the term while writing a story detailing the state's education funding. ***Sources:*** The contemporary news reportings and articles which appeared during the time in *The Economist, The Guardian, The New York Times* and *The Newsweek*.
12. 'Long-term investors' include SEBI-registered 'sovereign wealth funds' (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks.
13. As per the *SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations),* **Category I AIF** are – those AIFs with 'positive spillover effects' on the economy, for which certain incentives or concessions might be considered by SEBI or the Government of India or other regulators in India; and which shall include *Venture Capital Funds, SME Funds, Social Venture Funds, Infrastructure Funds* and such other *Alternative Investment Funds (AIFs)* as may be specified.
14. Samuelson and Nordhaus, ***Economics***, op. cit., p. 207.

15. **Economic Survey 2011-12** (p.34) quotes many contemporary references to bring the point home –

    a). R. Rajan, and L. Zingales (1998), 'Financial Dependence and Growth,' *American Economic Review*, vol. 88; **b).** S. Banerji, K. Gangopadhyay, I. Patnaik, and A, Shah (2012), 'New Thinking on Corporate Debt in India', mimeo.; **c).** C. K. G. Nair, (2012) 'Financial Sector Reforms: Refining the Architecture,' in R. Malhotra (ed.), *A Critical Decade: Policies for India's Development,* Oxford University Press, New Delhi; **d).** T. A. Bhavani, and N. R. Bhanumurthy (2012), *Financial Access in Post-Reform India,* Oxford University Press, New Delhi, Chapter 12; **e).** P. Bolton, and X. Freixas, 'How can Emerging Market Economies Benefit from a Corporate Bond Market?', in E. Borzenstein, K. Cowan, B. Eichengreen, and U. Panizza,(eds) (2008), *Bond Markets in Latin America*, MIT Press.

16. ***Haircut*** is the difference between prices at which a *market maker* can buy and sell a security. The term comes from the fact that market makers can trade at such a *thin spread*. It also means that the percentage by which an asset's market value is reduced for the purpose of calculating capital requirement, margin and collateral. When they are used as collateral, securities will generally be devalued since a cushion is required by the lending parties in case the market value falls.

17. ***Unwind*** is used to close out a position that has offsetting investments or the correction of an error. Unwinds occur when, for example, a broker mistakenly sells part of a position when an investor wanted to add to it. The broker would have to unwind the transaction by selling the erroneously purchased stock and buying the proper stock. One type of investing that features unwind trading is *arbitrage investing (as happens in the CDS)*. If, for the sake of illustration, an investor takes a long position in stocks, while at the same time selling puts on the same issue, he will need to unwind those trades at some point. Of course, this entails covering the options and selling the underlying stock. A similar process would be followed by a broker attempting to correct a buying or selling error.

18. RBI, 16th January, 2013

19. The **FSB** was established in April 2009 as the successor to the Financial Stability Forum (FSF). The FSF was founded in 1999 by the G–7 for enhancing cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system. In November 2008, the leaders of the G–20 countries called for a larger membership of the FSF. As announced in the G–20 Leaders Summit of *April 2009*, the expanded FSF was re-established as the *Financial Stability Board (FSB)* with a broadened mandate to promote financial stability. The FSB is chaired by *Mark Carney*, Governor of the Bank of Canada. Its secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

    Its ***objective*** is to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. [*Source*: Financial Stability Board Secretariat, Bank for International Settlements, Basel , Switzerland].

20. The **BCBS** (Basel Committee on Banking Supervision) provides a forum for regular cooperation on banking supervisory matters. The Committee's members, today, come from 27 nations including India. The present Chairman of the Committee is *Stefan Ingves*, Governor of Sveriges Riksbank. It is located at the Bank for International Settlements (BIS) in Basel, Switzerland.

    Its ***objective*** is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques, with a view to promoting common understanding. At times, the Committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable. In this regard, the Committee is ***best known*** for its international standards on ***Capital Adequacy*** *(i.e Basel I, Basel II and Basel III, by now)*; the ***Core Principles for Effective Banking Supervision***; and the ***Concordat*** on cross-border banking supervision.

    The *Committee* encourages contacts and cooperation among its members and other banking supervisory authorities. It circulates to supervisors throughout the world both published and unpublished papers providing guidance on banking supervisory matters. Contacts have been further strengthened by an *International Conference of Banking Supervisors (ICBS)* which takes place every two years. [*Source*: BIS, Basel, Switzerlad].

21. See **Chapter 16** for detailed discussion on the **IMF** (International Monetary Fund).

15

EXTERNAL SECTOR OF INDIA

*No country in today's globalized world can be fully insulated from what happens in the global economy and India is no exception to the rule. As the country is increasingly integrated into the world, it cannot remain impervious to developments abroad. The unfolding of the euro zone crisis and uncertainty surrounding the global economy have impacted the Indian economy causing drop in growth, higher current account deficit and declining capital inflows.**

- Definition
- Foreign Currency Assets
- Fixed currency Regime
- Floating Currency Regime
- Managed Exchange Rates
- Foreign Exchange Market
- Exchange Rate in India
- Trade Balance
- Trade Policy
- Depreciation
- Devaluation
- Revaluation
- Appreciation
- Current Account
- Capital Account
- Balance of Payment (BoP)

** As writes the MoF, Economic Survey 2012-13, GoI, N Delhi, p. 131.*

- Convertibility
- LERMS
- NEER
- REER
- EFF
- IMF Conditions on India
- Hard Currency
- Soft Currency
- Hot Currency
- Heated Currency
- Cheap currency
- Dear Currency
- Special Economic Zone
- GAAR
- Euro Zone Crisis & India
- FDI Liberalised
- India's Forex Reserves
- Risks in Forein Currency Borrowings
- Gold Imports - a menae
- Recent RTAs by India
- Autonomous Bodies
- Other Organisations
- Advisory Bodies

DEFINITION

All economic activities of an economy which take place in foreign currency fall in sectors such as export, import, foreign investment, external debt, current account, capital account, balance of payment, etc. to name a few (***definition***).[1]

FOREIGN CURRENCY ASSETS

The sum total of all the foreign currencies an economy possesses at a particular time is its foreign currency assets/reserves.[2] As per the Ministry of Finance, India's total foreign exchange reserves (comprising foreign currency assets, gold reserves, SDRs and Reserve Tranche in IMF) was at US $ 304.8 billion on March 31, 2013 ($ 294.4 billion on March 31, 2012).

The total capacity of an economy to manage liquid foreign exchange is its foreign exchange (Forex) reserve. This contains basically three components—the foreign currency assets, the total gold reserves and the total special drawing rights (SDRs) of an economy in the IMF.[3]

FIXED CURRENCY REGIME[4]

A method of regulating exchange rates of world currencies brought by the IMF. In this system exchange rate of a particular currency was fixed by the IMF keeping the currency in front of a basket of importanft world currencies (they were UK£, US $, Japanese ¥, German Mark DM and the French Franc FFr). Different economies were supposed to maintain that particular exchange rate in future. Exchange rates of currencies were modified by the IMF from time to time.

FLOATING CURRENCY REGIME[5]

A method of regulating exchange rates of world currencies based on the market mechanism (i.e., demand and supply). In the follow up to the fixed currency system of exchange rate determination, it was the UK which blamed the system for its payment crisis of late 1960s. Looking at the major loopholes in this system, the UK Government decided to switch-over to the floating currency regime in 1973—the same year the IMF allowed an option to its member countries to go for either of the currency systems.

In the floating exchange rate system, a domestic currency is left free to float against a number of foreign currencies in its foreign exchange market and determine its own value. Such exchange rates, are also called as *market driven* or *based* exchange rates, which are regulated by the factors such as the demand and supply of the domestic and the foreign currencies in the concerned economy.

MANAGED EXCHANGE RATES

A managed-exchange-rate system is a hybrid or mixture of the fixed and flexible exchange rate systems in which the government of the economy attempts to affect the exchange rate ***directly*** by buying or selling foreign currencies or ***indirectly***, through monetary policy[6] (i.e., by lowering or raising interest rates on foreign currency bank accounts, affecting foreign investment, etc.).

Today, most of the economies have shifted to this system of exchange rate determination. Almost all countries tend to intervene when the markets become ***disorderly*** or the ***fundamentals*** of economics are challenged by the exchange rate of the time. Some of the major examples of the managed exchange-rate system have been given below[7] :

(i) Some countries allow to ***free float*** their currencies and allow the market forces to determine their exchange rate with rare government intervention. This is the idea from which the ***floating currency regime*** basically emerged. The USA and the EU are the major examples in this category.

(ii) Some economies have ***managed but flexible*** exchange rates, under which the governments buy or sell its currency to reduce day-to-day volatility of currency fluctuations and sometimes go for systematic intervention for desired objectives. Canada and Japan fall in this category, besides many developing countries. India too falls under this category which follows the ***dual currency regime*** since 1992–93 financial year.[8]

(iii) Some economies, particularly small ones, peg their currencies to a major currency or to a ***basket*** of currency in a fixed exchange rate—known as the ***pegging of currencies.*** At times, the peg is allowed to glide smoothly upward or downward—a system which is known as ***gliding*** or ***crawling peg.*** Some economies have a ***hard fix*** of a ***currency board.*** A ***currency board*** is working well in Hong Kong while the fsame failed in Argentina in 2002.

FOREIGN EXCHANGE MARKET

The market where different currencies can be bought and sold is called the foreign exchange market.[9] Out of the trades in different currencies, the exchange rate of the currency is determined by the economy.[10] This is an institutional framework for the exchange of one national currency for another.[11] This is particularly correct either in the case of a free float exchange (i.e., floating currency) regime or is a managed or hybrid exchange rate system. It is altogether not allowed either in a ***fixed currency system*** or a ***hard fix*** (in a hard fix this happens once the currency to which the hard fix has been done itself starts fluctuating).

EXCHANGE RATE IN INDIA

Indian currency the ‘rupee’ was historically linked with the British Pound Sterling till 1948 which was fixed as far back as 1928. Once the IMF came up, India shifted to the fixed currency system

committed to maintain rupee's external value (i.e., exchange rate) in terms of gold or the US ($ dollar). In 1948, `3.30 was fixed equivalent to US $ 1.

In September 1975, India delinked rupee from the British pound and the RBI started determining rupee's exchange rate with respect to the exchange rate movements of the basket of world currencies (£, $, ¥, DM, Fr.). This was an arrangement between the fixed and the floating currency regimes.

In 1992–93 financial year, India moved to the floating currency regime with its own method which is known as the 'dual exchange rate'[12]. There are two exchange rates for rupee, one is the 'official rate' and the other is the 'market rate'. Here the point should be noted that it is the everyday's changing market-based exchange rate of rupee which affects the official exchange rate and not the other way round. But the RBI may intervene in the forex market via the demand and supply of rupee or the foreign currencies. Another point which should be kept in mind is that none of the economies have till date followed an ideal free-floating exchange rate. They require some mechanism to intervene in the foreign exchange market because this is a highly speculative market.

TRADE BALANCE

The monetary difference of the total export and import of an economy in one financial year is called trade balance. It might be positive or negative, known to be either favourable or unfavourable, respectively to the economy.

TRADE POLICY

Broadly speaking, the economic policy which regulates the export-import activities of any economy is known as the trade policy. It is also called the Foreign Trade Policy or the Exim Policy. This policy needs regular modifications depending upon the economic policies of the economies of the world or the trading partners.[13]

DEPRECIATION

This term is used to mean two different things. In foreign exchange market, it is a situation when domestic currency loses its value in front of a foreign currency if it is market-driven. It means depreciation in a currency can only take place if the economy follows the floating exchange rate system.

In domestic economy, depreciation means an asset losing its value due to either its use, wear and tear or due to other economic reasons. Depreciation here means *wear and tear*. This is also known as ***capital consumption.*** Every economy has an official annual rates/for different assets at which fixed assets are considered depreciating.

DEVALUATION

In the foreign exchange market when exchange rate of a domestic currency is cut down by its government against any foreign currency, it is called devaluation. It means official depreciation is devaluation.

REVALUATION

A term used in foreign exchange market which means a government increasing the exchange rate of its currency against any foreign currency. It is official appreciation.

APPRECIATION

In foreign exchange market, if a free floating domestic currency increases its value against the value of a foreign currency, it is appreciation. In domestic economy, if a fixed asset has seen increase in its value it is also known as appreciation. Appreciation rates for different assets are not fixed by any government as they depend upon many factors which are unseen.

CURRENT ACCOUNT

It has two meanings—one is related to the banking sector and other to the external sector:

i. In banking industry, a business firm bank account is known as current account. The account is in the name of a firm run by authorised person or persons in which no interest is paid by the bank on the deposits. Every withdrawal from the account takes place by cheques with limitations on the number of deposits and withdrawals in a single day. The *overdraft* facility or the *cash-cum-credit* (c/c Account) facility to business firms is offered by the banks on this account only.

ii. In the external sector, it refers to the account maintained by every government of the world in which every kind of current transactions is shown—basically this account is maintained by the central banking body of the economy on behalf of the government. Current transactions of an economy in foreign currency all over the world are—export, import, interest payments, foreign investment in shares.

All transactions are shown as either inflow or outflow (credit or debit). At the end of the year, the current account might be positive or negative.The positive one is known as a surplus current account, and the negative one is known as a deficit current account. India had surplus current accounts for three consecutive years (2000–03)—the only such period.

Current account deficit is shown either numerically by showing the total monetary amount of the deficit, or in percentage of the GDP of the economy for the concerned year. Both the data are used in analysis as per the specific requirement.

CAPITAL ACCOUNT

Every government of the world maintains a capital account which shows the capital kind of transactions of the economy with the outside economies. Every transaction in foreign currency (inflow or outflow) considered as capital is shown in this account—external lending or borrowing, private remittance's inflow or outflow, issuing of external bonds, etc.

There is no deficit or surplus in this account like the current account.

BALANCE OF PAYMENT (BoP)

The outcome of the total transactions of an economy with the outside world in one year is known as the balance of payment (BoP) of the economy.[14] Basically, it is the net outcome of the current and capital accounts of an economy. It might be favourable or unfavourable for the economy. However, negativity of the BoP does not mean it is unfavourable. A negative BoP is unfavourable for an economy if only the economy lacks the means to fill the gap of negativity.

The BoP of an economy is calculated on the principles of accountancy (***double-entry book-keeping***)[15] and looks like the balance sheet of a company—every entry shown either as credit (inflow) or debit (outflow). If there is a positive outcome at the end of the year, the money is automatically transferred to the foreign exchange reserves of the economy. And if there is any negative outcome, the same foreign exchange is drawn from the country's forex reserves. If the forex reserves are not capable of fulfilling the negativity created by the BoP, it is known as a BoP crisis and the economy tries different means to solve the crisis in which going for forex help from the IMF is the last resort.

CONVERTIBILITY

An economy might allow its currency full or partial convertibility in the current and the capital accounts. If domestic currency is allowed to convert into foreign currency for all current account purposes, it is a case of full current account convertibility. Similarly, in cases of capital outflow, if domestic currency is allowed to convert into foreign currency, it is a case of full capital account convertibility. If the situation is of partial convertibility, then the portion allowed by the government can be converted into foreign currency for current and capital purposes. It should always be kept in mind that the issue of currency convertibility is concerned with foreign currency *outflow* only.

Convertibility in India

India's foreign exchange earning capacity was always poor and hence it had all possible provisions to check the foreign exchange outflow, be it for current purposes or capital purposes (remember the draconian FERA!). But the process of economic reforms has changed the situation to unidentifiable

levels—

Current Account

Current account is today fully convertible (operationalised on August 19, 1994). It means that the full amount of the foreign exchange required by someone for current purposes will be made available to him at official exchange rate and there could be an unprohibited outflow of foreign exchange (earlier it was partially convertible). India was obliged to do so as per Article VIII of the IMF which prohibits any exchange restrictions on current international transactions (keep in mind that India was under pre-conditions of the IMF since 1991!).

Capital Account

After the recomendations of the S.S. Tarapore Committee (1997) on the Capital Account Convertibility, India has been moving in the direction of allowing full convertibility in this account but with required precautions. India is still a country of partial convertibility (40:60) in the capital account but inside this overall policy, enough reforms have been made and to certain levels of foreign exchange requirements, it is an economy allowing full capital account convertibility—

i. Indian Corporates are allowed full convertibility in the automatic route upto $ 500 million overseas ventures (investment by Ltd. companies in foreign countries allowed).
ii. Indian Corporates are allowed to prepay their external commercial borrowings (ECBs) via automatic route if the loan is above $ 500 million (now done $ 20,000)
iii. Individuals are allowed to invest in foreign assets, shares, etc. upto the level of $ 2,00,000 per annum.
iv. Unlimited amount of gold is allowed to be imported (this is equal to allowing full convertibility in capital account via current account route but not feasible for everybody) and is not allowed now.

The Second Committee on the Capital Account Convertibility (CAC)—again chaired by S.S. Tarapore—handed over its report in September 2006 on which the RBI/the Government is having consultations.

LERMS

India announced the Liberalised Exchange Rate Mechanism System (LERMS) in the Union Budget 1992–93 and in March 1993 it was operationalised. India delinked its currency from the fixed currency system and moved into the era of floating exchange-rate system under it.

Indian form of exchange rate is known as the 'dual exchange rate', one exchange rate of rupee is official and the other is market-driven.[16] The market-driven exchange rate shows the actual tendencies of the foreign currency demand and supply in the economy vis-a-vis the domestic currency. It is the market-driven exchange rate which affects the official rate and not the other way round.

NEER

The Nominal Effective Exchange Rate (NEER) of the rupee is a weighted average of exchange rates before the currencies of India's major trading partners.

REER

When the weight of inflation is adjusted with the NEER, we get the Real Effective Exchange Rate (REER) of the rupee. Since inflation has been on the higher side in recent months, the REER of the rupee has been more against it than the NEER.

EFF

The Extended Fund Facility (EFF) is a service provided by the IMF to its member countries which authorises them to raise any amount of foreign exchange from it to fulfill their BoP crisis, but on the conditions of structural reforms in the economy put by the body. It is the first agreement of its kind. India had signed this agreement with the IMF in the financial year 1981–82.

IMF CONDITIONS ON INDIA

The BoP crisis of early 1990s made India borrow from the IMF which came on some conditions. The medium term loan to India was given for the restructuring of the economy on the following conditions—

i. Devaluation of rupee by 22 per cent (done in two consecutive fortnights—rupee fell from '21 to '27 against every US Dollar).

ii. Drastic custom cut to a peak duty of 30 per cent from the erstwhile level of 130 per cent for all goods.

iii. Excise duty to be increased by 20 per cent to neutralise the loss of revenue due to custom cut.

iv. Government expenditure to be cut by 10 per cent per annum (the burden of salaries, pensions, subsidies, etc.).

The above-given conditions to which India was obliged were vehemently opposed by the Indian corporate sector, opposition in the parliament and majority of Indians. But by the end of 1999–2000, when India saw every logic in strengthening its BoP position there was no ideological opposition to the idea. It should always be kept in mind that the nature of structural reforms India went through were guided and decided by these pre-conditions of the IMF.

This is how the direction of structural reforms of an economy are regulated by the IMF in the process of strengthening the BoP position of the crisis-driven economy. The purpose has been served in the Indian case. India has not only fulfilled these conditions but it has also moved ahead.

HARD CURRENCY

It is the international currency in which the highest faith is shown and is needed by every economy. The strongest currency of the world is one which has a high level of liquidity. Basically, the economy with the highest as well as highly diversified exports that are compulsive imports for other countries (as of high level technology, defence products, life saving medicines and petroleum products) will also create high demand for its currency in the world and become the hard currency. It is always scarce.

Upto the Second World War, the best hard currency was the Pound Sterling (£) of the UK but soon it was replaced by the US$—at present some experts believe that the Euroland's currency (€) might replace it, too. Some of the best hard currencies of the world today are the US dollar, the Euro(€), Japanese Yen (¥) and the UK Sterling Pound (£).

SOFT CURRENCY

A term used in the foreign exchange market which denotes the currency that is easily available in any economy in its forex market. For example, rupee is a soft currency in the Indian forex market. It is basically the opposite term for the hard currency.

HOT CURRENCY

A term of the forex market and is a temporary name for any hard currency. Due to certain reasons, if a hard currency is exiting an economy at a fast pace for the time, the *hard* currency is known to be *hot*. As in the case of the SE Asian crisis, the US dollar had become hot.

HEATED CURRENCY

A term used in forex market to denote the domestic currency which is under enough pressure (heat) of depreciation due to a hard currency's high tendency of exiting the economy (since it has become hot). It is also known as *currency under heat* or *under hammering*.

CHEAP CURRENCY

A term first used by the economist J. M. Keynes (1930s). If a government starts re-purchasing its bonds before their maturities (at full-maturity prices) the money which flows into the economy is known as the cheap currency, also called cheap money.

In banking industry, it means a period of comparatively lower/softer interest rates regime.

DEAR CURRENCY

This term was popularised by the other economists in early 1930s to show the opposite of the cheap currency. When a goverment issues bonds, the money which flows from the public to the government or the money in the economy in general is called dear currency, also called as *dear money*.

In the banking industry, it means a period of comparatively higher/costlier interest rates regime.

SPECIAL ECONOMIC ZONE[17]

How does a country of over a billion people take on the challenge of providing a better life to its citizens? The question would naturally elicit a million different responses having their roots in several social, economic and political measures. No one today, however, doubts the efficacy of faster and broad-based economic development as a primary tool for providing the average Indian a better deal. The country needs massive investments in manufacturing, infrastructure development and in its productive capacities. We also need to aggressively promote exports of goods and services in an ever so highly competitive global marketplace. This alone would lead to a strong edifice for sustained growth and creation of productive employment. These were the very aims for which the Government of India mooted the Special Economic Zone (SEZ) Policy in April 2000 which was further concretised through the SEZ Act 2005 and the SEZ Rules 2006 policy.

The concept of SEZ is not a new one and it is an improvement to the concept of Export Processing Zones. India was *one of the first* in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with ***Asia's first*** EPZ set up in Kandla in 1965 – seven more EPZs were set up thereafter. However, the EPZs were not able to emerge as effective instruments for export promotion on account of multiplicity of controls and clearances, absence of world-class infrastructure, and an unstable fiscal regime. In order to overcome these shortcomings and attract larger foreign investments in India, the SEZ Policy was announced in April 2000. This policy was intended to make *SEZs an engine for economic growth* supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations.

What is SEZ?

SEZ, or Special Economic Zone, is essentially an industrial cluster meant largely for exports. An SEZ is governed by a special set of rules aimed at attracting direct investment for export-oriented production. SEZs, earlier known as Export Processing Zones or Free Trade Zones, are *duty free enclaves* which are treated as *foreign territory* only for trade operations, duties, tariffs and typically marked by the best infrastructure and least red tape. Other salient features of SEZs are:

- manufacturing or service activities are allowed;
- full freedom for sub-contracting;
- no routine examination by customs authorities of export/import cargo;

- units in SEZs have to become net foreign exchange earners within three years; and
- domestic sales from them are subject to full customs duty and the import policy in force.

The SEZ concept recognises the issues related to economic development and provides for developing self-sustaining Industrial Townships so that the increased economic activity does not create pressure on the existing infrastructure. This issue is addressed in the SEZ policy by specifying a non-processing area for creation of support infrastructure. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created. The SEZ developer would be responsible for all civic amenities and infrastructure including roads, sewerage, open spaces, green spaces, education facilities, power, water supply and housing etc.

Land Acquisition Issue & SEZ

While the benefits of SEZs are visible and evident, one major issue that has been often raised pertains to the acquisition of agricultural land for setting up SEZs. Acquisition of land is a matter that comes under the purview of the State Governments since land/ land usage is a State subject. While there is a *Central Land Acquisition Act* of 1894 extensively amended in 1971, the States have made modifications to the same and have their own compensation and relief & rehabilitation measures depending upon their requirements and necessities.

The need of the hour is to formulate a working Land Reforms and Land Acquisition Law which could address the emerging new realities (like agitations by farmers after the land has already been acquired and compensation paid to them) related to the issue of land acquisition. The second thing is an active and willing co-operation/participation coming from the state governments. Involving the PRIs will provide a more durable and effective way out to this issue.

Meanwhile, on the proposed and revised **Land Acquisition Bill, 2013**, a political concensus has been reached *(on April 18, 2013)* – which paved the way for the Bill to get introduced in the current Session of the Parliament – it will replace India's existing *Land Acquisition Act, 1894*. The Bill is more careful, realistic and futuristic about the contemporary and emerging challenges of land acquisition in the country – the major highlights of the Bill are as follows:

(i) For the first time, resettlement and rehabilitation both have been emphasised on the same footing;

(ii) Scrutiny of all private purchase of land between 2011 and 2013 (there has been a concern among many that the land mafias have grabbed cheap land from the farmers before the proposed Bill has been passed by the Government);

(iii) A provision to enable state legislation on leasing in place of acquisition of land;

(iv) Instead of acquisition, land to be leased to developers, so that the ownership remains with farmers and provides them a regular income – the government to amend the *Land Acquisition, Rehabilitation and Resettlement Bill, 2011*, to provide for an enabling provision to states for enacting laws in this regard (leasing of land is a state subject under the Constitution).

Experts, together with the GoI, beleive that once the new Act is implemented, the issue of land acquisition in the country will become more smooth and will be able to avoid the controversies which we saw in the recent times.

Performance of SEZs

As per the *Economic Survey 2012-13*, the performance of SEZs today is as given below –

- Since the Special Economic Zones Act and Rules were notified in February 2006, formal approvals have been granted for setting up of 579 SEZs, of which 384 have been notified.
- Of the total ***employment*** provided to 9,45,990 persons in SEZs as a whole, that to 8,11,286 persons is incremental employment generated after February 2006 when the SEZ Act came into force. This is apart from the million mandays of employment created by the developer for infrastructure activities.
- While in 2010-11, physical ***exports*** from SEZs were worth Rs. 3,15,867.85 crore, in 2011-12 the figure had gone up to Rs. 3,64,477.73 crore showing a *growth of 15.4 per cent*. The total physical exports from SEZs in the first half of the current financial year have been to the tune of app. Rs. 2,39,628 crore, registering a *growth of 36 per cent* over the last year.
- The ***total investment*** in SEZs till September 30, 2012 was app. Rs. 2,18,795.41 crore.
- As per the provisions of the SEZ Act 2005, ***100 per cent FDI*** is allowed in SEZs through the automatic route.
- A total of 160 SEZs are exporting goods and services – of this 93 are IT/ITES, 17 multi-product and 50 other sector-specific SEZs.
- The total number of units in these SEZs is 3308.

GAAR

The GAAR (General Anti-Avoidance Rules), originally proposed in the *Direct Taxes Code 2010*, are targeted at arrangements or transactions made specifically to avoid taxes. The government had decided to advance the introduction of GAAR and implement it from the financial year 2013-14 itself. More than 30 countries have introduced GAAR provisions in their respective tax codes to check such tax evasion.

The ***objective*** of the GAAR provisions is to codify the doctrine of *'substance over form'* where the real intention of the parties and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure of the concerned transaction or arrangement. It essentially comes into effect where an arrangement is entered into with the main purpose or one of the main purposes of obtaining a *tax benefit* and which also satisfies at least one of the following *four tests*:

(i) The arrangement creates rights and obligations that are not at arm's length,

(ii) It results in misuse or abuse of provisions of tax laws,

(iii) Lacks commercial substance or is deemed to lack commercial substance, or

(iv) it is not carried out in a bona fide manner.

Thus, if the tax officer believes that the main purpose or one of the main purposes of an arrangement is to obtain a tax benefit and even if one of the above *four tests* are satisfied, he has powers to declare it as an impermissible avoidance arrangement and re-characterise the entire transaction in a

manner that is more conducive to maximising tax revenues. There are many troubling aspects of this provision that will make doing business in India even more ***challenging***, than what it already is from a tax perspective –

- It is presumed that obtaining tax benefit is the main purpose of the arrangement unless otherwise proved by the taxpayer. This is an onerous burden that under a fair rule of law should be discharged by revenue collector and not the taxpayer. In fact, the *Parliamentary Standing Committee on DTC* has specifically recommended that the onus of proving the existence of a tax-avoidance motive and a transaction lacking commercial substance, should rest with the revenue invoking GAAR and not shifted to the taxpayer. This is essentially to ensure that the revenue authorities exercise proper discretion, proper application of mind and gather enough credible data and evidence before attempting to invoke far-reaching provisions such as GAAR.
- An arrangement will be deemed to lack commercial substance under GAAR if it involves the location of an asset or of a transaction or of the place of residence of any party that would not have been so located for any substantial commercial purpose other than obtaining tax benefit. This again is an amazingly wide provision that provides a great weapon in the armoury of the tax authorities to challenge almost every inbound or outbound transaction with respect to India, made through any of the favourable tax treaties that India has entered into. The government intention becomes visibly clear by one of the finance ministry replies to the *Standing Committee on DTC*, where it has made it clear that the GAAR provisions will check *treaty shopping* by the taxpayer for avoidance of payment of tax in India'.
- GAAR allows tax authorities to call a business arrangement or a transaction 'impermissible avoidance arrangement' if they feel it has been primarily entered into to avoid taxes. Once an arrangement is ruled 'impermissible' then the tax authorities can deny tax benefits. Most aggressive tax avoidance arrangements would be under the risk of being termed impermissible. It has a provision according to which the onus to prove that an arrangement is 'impermissible' will lie with the tax department. The GAAR panel, the final body that will decide on the applicability of the law, will include an independent member. The rule can apply on domestic as well as overseas transactions.
- GAAR is a very broadbased provision and can easily be applied to most tax-saving arrangements. Many experts feel that the provision would give unbridled powers to tax officers, allowing them to question any taxsaving deal. Foreign institutional investors are worried that their investments routed through Mauritius could be denied tax benefits enjoyed by them under the Indo-Mauritius Tax Treaty. The proposal *(announced in on May 8, 2012)* had spooked stock market as FII inflows dropped on concerns, and the rupee hit a low of Rs. 53.47 to the Dollar.

Meanwhile, the government has postponed GAAR to the next financial year (i.e., 2014-15). This will give a breather to tax payers and also allow the government time to frame clear rules after consultations with stakeholders.

EURO ZONE CRISIS & INDIA

The unfolding of Euro Zone Crisis, the austerity measures in advanced economies, recession in many euro zone countries, risk on/risk off behaviour of investors and the uncertainty surrounding the future of euro zone have adversely affected the global economy. The fallout for the Indian economy has been as given below –

- A sharp deceleration in *exports* and a slowdown in GDP growth;
- *Import* demand, however, has remained resilient because of the continued high international oil prices that did not decline, unlike what happened after the *Lehman meltdown* of September 2008.
- The high value of *gold* imports, driven mainly by the 'safe haven' demand for gold that has led to a sharp rise in prices, contributed to the high import bill and widening of the trade deficit.
- As per the ***Economic Survey 2012-13***, the trade deficit, as a result, increased to US$ 189.8 billion in 2011-12, which was 10.2 per cent of the GDP. The signs of *strain on BoP* continued in the first half of 2012-13 (April–September 2012) with the trade deficit increasing to 10.8 per cent of GDP and CAD (current account deficit) at 4.6 per cent of GDP. The CAD peaked to *'an all-time high'* of **6.7** per cent by ***end-March 2013*** *(as per the MoF and the RBI).*
- The CAD is estimated to be **5.1** per cent for 2012-13 as per the latest document ***'Review of the Economy 2012-13'*** (released on **April 23, 2013** by Dr. C. Rangarajan, Chairman, Economic Advisory Council to the Prime Minister). The document has estimated the CAD for fiscal *2013-14* at **4.7** per cent.

The high CAD has had implications for rupee volatility and business confidence in the economy. A positive development is that high CAD has lately been financed by capital inflows, which explains why the downhill movement of rupee, witnessed till July 2012, has been largely arrested. There has, however, been high dependence on volatile portfolio flows and external commercial borrowings. This makes capital account vulnerable to a 'reversal' and 'sudden stop' of capital, especially in times of stress.

The foreign **investment environment** of India has been directly affected by the crisis – the main fallout of the euro zone crisis is global uncertainty. This has led to investors' alternating between ***risk-on*** and ***risk-off*** behaviour, with consequent implications for surge and reversal of capital to emerging economies. A risk-on, prompted by new policy initiatives, creates a favourable disposition towards emerging economy investment, leading to surge in FIIs flows and vice versa –

- While change in investor attitude is generally observable in the long-run, the fallout of the euro zone crisis has been quick shift between risk-on/risk-off behaviour that has immediate implications for capital flows. An additional factor has been quantitative easing in the US. This increases the supply of liquidity in the system and together with low interest environment and better growth prospects in emerging economies, contributes to increase in capital flows.
- A closer look at the global risk-on/off events and FII flows to India shows strong correlation between such events and surge and reversal of capital. For example, the US credit rating downgrade in early August 2011, together with worsening of euro crisis, created a risk-off environment. As a result, there was net withdrawal of FII investment of US$ 3.7 billion during

August-October 2011.

- The *Long Term Refinancing Operation* (LTRO) of European Central Bank that injected more than Euro 1 trillion in the banking system in two tranche in December 2011 and February 2012 again created a risk-on environ. As a result, there was a net FII inflow of US$ 16.9 billion during December 2011–February 2012. The investor euphoria soon evaporated as the euro crisis worsened and the spectre of Greek exit loomed. Consequently, the investor behaviour again became risk-off, leading to net FII outflow of US$ 2.3 billion during March–June 2012.

The *investment climate began improving* in ***July 2012*** with –

(i) Announcement by European Central Bank President that the euro would be saved at all cost;

(ii) Proposal to set-up Banking Union in the euro zone;

(iii) Launch of permanent European Stability Mechanism; and

(iv) Launch of QE3 in US. The resulting risk-on atmosphere has seen a net FII inflow of US$ 10.8 billion during July–October, 2012.

FDI LIBERALIZATION

Foreign Direct Investment (FDI) is preferred to the foreign portfolio investments (PIS) primarily because FDI is expected to bring modern technology, managerial practices and has a long–term nature of investment. The government has liberalized FDI norms overtime. As a result, *only a handful of sensitive sectors now fall in the prohibited zone* and FDI is allowed fully or partially in the rest of the sectors.

Despite successive moves to liberalize the FDI regime, India is ranked **fourth** on the basis of ***FDI Restrictiveness Index (FRI)*** compiled by **OECD**. FRI gauges the restrictiveness of a country's FDI rules by looking at the ***four*** main types of restrictions:

(i) Foreign equity limitations;

(ii) Screening or approval mechanism;

(iii) Restrictions on the employment of foreigners as key personnel; and

(iv) Operational restrictions.

A score of **1** indicates a closed economy and **0** indicates openness. FRI for India in 2012 was **0.273** (it was 0.450 in 2006 and 0.297 in 2010) as against OECD average of ***0.081***. *China* is the most restrictive country as it is ranked number ***one*** with the score of 0.407 in 2012 indicating that it has more restriction than India. As there is moderation in FDI inflows to India in 2012-13 tahn the last year it is imperative therefore to *rationalize FDI norms* further (as is suggested by the ***Economic Survey 2012-13***). The Survey further adds –

- At present, ***defence sector*** is open to FDI subject to 26 per cent cap. It also requires FIPB approval and is subject to licensing. Within the 26 per cent cap, FII is also permissible subject to the proviso that overall cap is not breached. India needs to open up the defence production sector to get access and ensure transfer of technology. The existing FDI policy for defence sector provides for offsets policy. The offsets policy has been revised recently but its

direct and indirect benefits have not had visible impact on the domestic defence industry. By beginning to produce defence goods that advanced countries currently produce, there is scope for productivity improvement, strengthening of manufacturing, generation of employment and lowering of imports in the country.

- There is need to review increasing of FDI cap in ***insurance***. By raising cap to 49 per cent in the insurance sector, there is scope for substantial growth in the coming years. Competition and adoption of best practices could strengthen this sector, reduce premium and expand the services to the vast untapped rural India. This sector could be one of the major sources of long-term investment in infrastructure.
- Similarly, FDI limit in ***public sector banks*** could be increased to 26 per cent.
- There is also a need to review existing approval mechanisms, operational restrictions and conditions in other sectors to attract foreign investment.

INDIA'S FOREX RESERVES

The distinction between convertible and non-convertible currencies is important for emerging economies, as most transactions with the rest of the world are in convertible currencies like US Dollar, Euro, Pound Sterling, Yen, Swiss Franc, etc. The need for increasing the availability of convertible currency for self-insurance has also been behind the race to build-up foreign exchange reserves (FER) in emerging economies after the Asian Crisis of 1997. Such FER accumulation, however, is constrained by the fact that it is possible only in times of currency appreciation. India's attempts at building up the Forex Reserve may be seen as given below (as has been summed up by the ***Economic Survey 2012-13***) –

- Following the BoP crisis of 1990-91 that was essentially due to depletion of foreign exchange reserves, there was a conscious effort by the RBI to build up FER. This was done through buying foreign currency in the market during periods of surge in capital flows. As a result, FER levels increased from US$ 5.8 billion in 1990-91 to US$ 314.6 billion at end May 2008.
- The RBI is however following a hands-off policy in foreign exchange market after the 2008 global crisis, with intervention limited to curbing excess rupee volatility. As a result, during 2009-10 and 2010-11, when rupee was appreciating due to increase in capital flows, there was virtually no intervention to build up FER. The sharp decline in rupee in 2011-12, however, led the RBI to inject foreign exchange to the extent of US$ 20.1 billion to stem the rupee slide. The pressure on currency has continued in the financial year ***2012-13*** because of the ongoing euro-zone crisis.
- The import cover of FER, as a result, has declined from 14.4 months of imports in 2007-08 to 7.1 months in 2011-12. There are costs to intervention. The main cost is the release of corresponding rupee liquidity, when RBI intervenes in the market to buy foreign exchange. This may stoke ***inflation***, which may not appeal in the current inflationary situation.
- Past experience, however, shows that measures like *Market Stabilization Scheme* (MSS) have been effective in draining excess liquidity from the system. Countries like China and Turkey use cash reserve ratio (CRR) for the same purpose. The cost of a particular policy,

however, has to be weighed against the benefits, which are manifold –

(i) Intervention to buy FER during surge in capital leads to build-up of reserves, which provides self-insurance against external vulnerability.

(ii) The higher reserve levels restore investor confidence and may lead to an increase in foreign direct and portfolio investment flows that spurs growth and helps bridge the current account deficit.

(iii) In a scenario of high trade and CAD, as in India, allowing the currency to appreciate through non-intervention during times of surge in capital, could have further negative fallout for the BoP by making exports less competitive and imports cheaper.

(iv) Lastly, buying foreign exchange provides more ammunition or intervention when the currency is declining, which could potentially lower currency volatility.

RISKS IN FOREIGN CURRENCY BORROWINGS

Corporate borrowers in India and other emerging economies are keen to borrow in foreign currency to benefit from lower interest and longer terms of credit. Such borrowings however, are not always helpful, especially in times of high currency volatility. During good times, domestic borrowers could enjoy triple benefits of –

(i) lower interest rates,

(ii) longer maturity, and

(iii) capital gains

– due to domestic currency appreciation. This would happen when the local currency is appreciating due to surge in capital flows and the debt service liability is falling in domestic currency terms. The opposite would happen when the domestic currency is depreciating due to reversal of capital flows during crisis situations, *as happened during the 2008 global crisis*.

A sharp depreciation in local currency would mean corresponding *increase in debt service liability*, as more domestic currency would be required to buy the same amount of foreign exchange for debt service payments. This would lead to ***erosion in profit*** margin and have 'mark-to-market' implications for the corporate. There would also be 'debt overhang' problem, as the volume of debt would rise in local currency terms. Together, these factors could create corporate distress, especially because the rupee tends to depreciate precisely when the Indian economy is also under stress, and corporate revenues and margins are under pressure.

In this context, it is felt that one of the factors contributing to faster recovery of the Indian economy after the 2008 global crisis was the low level of corporate external debt. As a result, the significant decline in the value of rupee did not have a major fallout for the corporate balance-sheets. Foreign currency borrowings, therefore, have to be contracted carefully, especially when no 'natural hedge' is available. Such natural hedge would happen when a foreign currency borrower also has an export market for its products. As a result, export receivables would offset, at least to some extent, the currency risk inherent in debt service payments. This happens because fall in the value of the rupee that leads to higher debt service payments is partly compensated by the increase in the value of rupee

receivables through exports.

When export receivables and the currency of borrowings is different, the *prudent approach* is for corporations to enter *currency swaps* to re-denominate asset and liability in the same currency to create natural hedge. Unfortunately, too many Indian corporations with little foreign currency earnings leave foreign currency borrowings unhedged, so as to profit from low international interest rates. This is a dangerous gamble for reasons described above and should be avoided – as the *Economic Survey 2012-13* suggests.

GOLD IMPORTS – A MENACE!

Rising gold imports has been among the major external sector concerns[18] for India in the *recent times*. India is one of the largest importers of gold in the world, with import growth of **11.2** per cent in terms of quantity and **39.0** per cent in terms of value during 2011-12. Gold is the **second** major import item of India ***after POL*** and constitutes **11.3** of its imports in 2011-12 in value terms.

The rise in imports of gold is one of the factors contributing to India's high trade deficit and CAD in 2011-12, forming **30** per cent of its trade deficit. The RBI in its draft report of the *Working Group to Study 'Issues Related to Gold Imports and Gold Loans by NBFCs in India'* has stated that if gold imports in India had grown by 24 per cent (an average of growth in world gold demand during past three years) instead of 39 per cent in 2011-12, the CAD would have been lower by approximately US$ 6 billion and the CAD-GDP ratio would have been 3.9 per cent instead of 4.2 per cent.

Globally, the demand for gold is rising, mainly due to demand from emerging economies like *China* and ***India***. The major source countries for import of gold include Switzerland, responsible for **52** per cent of the total imports by India of raw gold during 2011-12 (which has led to an unfavourable bilateral balance of trade for India), followed by the UAE (17.6 per cent), and South Africa (11.5 per cent). The rise in gold imports is due to many factors:

- The love of Indians for the yellow metal is well known – India is one of the largest consumers of gold in the world with consumption increasing from 721.9 tonnes in 2006 to 933.4 tonnes in 2011 and 612 tonnes in the first three quarters of 2012, accounting for around 27 per cent of world gold consumption in 2011, and 26.4 per cent in 2012 (total of first three quarters).
- As per the *Annual Report 2011-12* of the Ministry of Mines, ***domestic production*** of gold is estimated at only 2.8 tonnes in 2011-12 and can meet around **0.3** per cent of the demand. This has inevitably led to its import.
- Gold is also used for trading/investment. Net retail investment constitutes 39.2 per cent of India's total gold consumption in 2011 and 32.5 per cent during the first three quarters of 2012 in terms of quantity. As stated in the RBI report, one of the major components of gold demand in recent years has been investment demand at global level.
- Rising gold prices in recent years have not deterred the acquisition of gold in India, implying that investment in gold is becoming ***price inelastic*** and its price was about to fall any time *(as India saw a 30 per cent fall in gold prices within one week – the 2nd week of **April, 2013**)*.
- India also imports gold for manufacturing purposes and exports a portion of it as jewellery. In

the case of export of gold jewellery, the major export destinations include the UAE (57.9 per cent), Hong Kong (14.1 per cent), and the USA (12.0 per cent).

International gold price movements which have been volatile in recent years also have a bearing on the value of the country's gold imports. During 2000-12, international gold prices have grown at a CAGR (Compound Annual Growth Rate) of 16.2 per cent. In 2011–12 they increased by 23.4 per cent though they moderated to 4.3 per cent during April–November 2012 over the corresponding period in the previous year. Even with this moderation, gold prices were at a high level of US $1721 per troy ounce in November 2012 and at US $ 1672.3 per troy ounce (as on ***February 15, 2013***).

- As stated by the *RBI Report*, volatility in international gold prices in recent quarters is ***positively skewed***, implying that it provides fewer large losses and a greater number of larger gains. The worsening global situation has also led to a rise in purchase of gold as a ***safety metal*** and a further rise in its price.
- Fluctuations in international gold prices get automatically reflected in India's gold prices along with the markup due to duties and taxes. Substantial increase in gold prices seems to have fuelled positive price expectations also contributing to sharp rise in the value of gold imports in recent years.

To restrict the rising trend in gold imports which is adversely affecting India's balance of payments, measures were and are being taken by the government:

- In Budget 2012-13, import duty on standard gold and platinum was raised from 2 per cent to 4 per cent and non–standard gold from 5 per cent to 10 per cent.
- On January 21, 2013, the Import duty on gold and platinum was increased from 4 per cent to 6 per cent.
- It has also been proposed to provide a link between the ***Gold ETF*** (Exchange Traded Fund) and ***Gold Deposit Scheme*** with the objective of '*unfreezing*' or '*releasing*' a part of the gold physically held by mutual funds under Gold ETFs and enabling them to deposit the gold with banks under the Gold Deposit Scheme.

The value of gold imports during *April–December 2012* declined by 14.7 per cent to US $ 38.02 billion and quantity of imports fell by 11.8 per cent compared to same period of previous year. Total gold consumption has also declined by 23 per cent during the first three quarters of 2012. While the supply of gold through organized channels can be constricted, there is need to be vigilant regarding gold inflows through unauthorized channels. Ultimately, the best way to reduce gold imports in a sustainable way will be to offer the public financial investment opportunities that generate attractive returns. This means bringing down *inflation* as well as expanding the range of investments investors have easy access to.

RECENT RTAs BY INDIA

Since India became one of the founding members of the WTO, its attention has grown towards the regional trade groupings. These groupings give regional competitveness to the economy and strengthens it to compete at the global level in a more organised way. Recent developments with

regard to India's regional trade agreements (RTAs) have been given below[19] –

SAFTA

The SAFTA (South Asia Free Trade Area) Agreement came into force on January 1, 2006 – under it, India has granted *zero basic custom* duty to all LDCs, viz. Afghanistan, Bangladesh, Bhutan, and Maldives, on all items except 25 items relating to alcohol and tobacco. Under the SAFTA Agreement, India has reduced the SAFTA Sensitive List for non-LDCs from 878 to 614 by reduction of 264 tariff lines from 6 September 2012. As per the schedule of Tariff Liberalisation Programme (TLP) under SAFTA, India has brought down its peak tariff rates to ***5 per cent from January 1, 2013***.

EHS

India-Thailand FTA, *Early Harvest Scheme* (EHS) under the Framework Agreement for establishing India-Thailand FTA was signed on 9th October 2003, which includes trade in goods, trade in services, investment, and other areas of economic cooperation, to be concluded as a single undertaking. Under EHS, tariff has gradually been eliminated on a list of 82 common items simultaneously by both sides between September 1, 2004 and August 31, 2006. Under the India-Thailand FTA, it is proposed to provide ASEAN plus tariff concessions. So far 26 rounds of the India-Thailand Trade Negotiation Committee (ITTNC) meetings have been held. The last round was held on November 26–27, 2012 in New Delhi.

CECA

India-ASEAN Comprehensive Economic Cooperation Agreement (CECA) Services and Investment Agreements was signed on August 13, 2009 under the broader framework of the CECA between India and ASEAN which has already come into force. Conclusions of negotiations for the Services Agreement and Investment Agreement have been announced during the ASEAN-India Commemorative Summit held on *December 20, 2012* in New Delhi – legal scrubbing for these agreements were finalized in February, 2013. The agreement will be signed during ASEAN Economic Ministers (AEM)-India Consultations in *August 2013*.

RCEP

During the 20th ASEAN Summit held in Cambodia in April 2012, ASEAN States agreed to move towards establishing an RCEP (Regional Comprehensive Economic Partnership) Agreement among *ASEAN + 6* (Australia, China, India, Japan, Korea, and New Zealand involving ASEAN and its FTA partners. The *objective* of launching RCEP negotiations is to achieve a modern, comprehensive, high-quality, and mutually beneficial economic partnership agreement among the ASEAN member States and ASEAN's FTA partners. The RCEP will *cover* trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, and other issues.

BITA

Fifteen rounds of negotiations and a number of inter-sessional and Chief Negotiator level meetings of BITA (India - EU Broad Based Trade and Investment Agreement) have been held till date. The 15th round was held during December 4–7, 2012 in New Delhi. Chief negotiator level meeting was held on *January 29–30, 2013* in New Delhi.

GSTP

The agreement establishing the GSTP (Global System of Trade Preferences) among developing countries was signed on April 13, 1988 at Belgrade following the conclusion of the First Round of Negotiations. Forty-three countries have ratified the agreement and become participants. India has offered tariff concessions on 70.08 per cent of dutiable tariff lines with an across-the-board *margin of preference* (MoP) of 20 per cent on the applied tariffs prevailing on the date of import. India has also unilaterally offered special concessions to LDC participants by granting an MoP of 25 per cent on 77 per cent of all its dutiable tariff lines. The Cabinet Committee on Economic Affairs (CCEA), in its meeting on August 23, 2012, has granted approval for implementing India's schedule of concessions. The tariff concessions are to be implemented 30 days after a minimum of four participants ratify their schedules of concessions. So far India and Malaysia have ratified their schedules.

AUTONOMOUS BODIES

The Government of India, time to time did set up many autonomous bodies in the form of boards, councils, organisations, etc. to promote the cause of external trade. A brief account of them is given below here:

Coffee Board

The **Coffee Board** was set up under Section (4) of the Coffee Act, 1942. It is the oldest Board under the Department of Commerce. The primary functions of the Board include formulating and implementing programmes and projects for growth and development of the coffee industry; promoting coffee consumption in India and exports in the international market; supporting research, extension and developmental activities for raising productivity; evolving pest and disease-resistant varieties; and prescribing and enforcing quality standards at all stages. The Board is headed by a Chairperson and functions from Bangalore. The Board administers four Regional Coffee Research Stations, a Coffee Research Institute, a number of Regional Field Stations and Coffee Demonstration Farms.

Rubber Board

The **Rubber Board** was set up under Section (4) of the Rubber Act, 1947 with headquarters at Kottayam and five Zonal Offices, thirty-nine Regional Offices, a number of Field Stations, Rubber Development Centres and Regional nurseries. It is headed by a Chairman. The Board is engaged in the development of the rubber industry. This is done by assisting and encouraging scientific, technical and economic research; supplying technical advice to rubber growers; training growers in improved

methods of planting, cultivation and manuring and collecting statistics from the owners of estates, dealers and manufacturers, etc.

Tea Board

The Tea Board was constituted as a statutory body on April 1, 1954 under Section (4) of the Tea Act, 1953. The Tea Board which forms an apex body for the tea industry in India, is headed by a Chairman with its head office at Kolkata. It has sixteen Regional and Sub-Regional Offices spread over different parts of India. Besides, the Board has three foreign offices. The primary functions of the Tea Board include rendering financial and technical assistance for cultivation, manufacture, and marketing of tea; promoting tea exports; aiding research and developmental activities for augmentation of tea production and improvement of tea quality; encouraging and assisting the unorganised small growers' sector financially and technically; collecting and maintaining statistical data and its publication for the benefit of growers, processors and exporters.

Tobacco Board

The Tobacco Board was set up as a statutory body on January 1, 1976 under the Tobacco Act, 1975. The Board with headquarters at Guntur in Andhra Pradesh, is headed by a Chairman and is responsible for the development of the tobacco industry. The Board also has a Directorate of Auctions at Bangalore. The primary functions of the Board include regulating the production and curing of Virginia Tobacco; keeping a constant watch on the Virginia Tobacco market in India and abroad; ensuring fair and remunerative prices to growers; maintaining and improving existing markets and developing new markets abroad by devising appropriate marketing strategies. The Board is entrusted with the tasks of recommending to the Central Government the minimum prices that may be fixed; regulating tobacco marketing in India and abroad with due regard to the interest of growers, manufacturers and dealers; propagating information useful to growers, traders and manufacturers and purchasing Virginia tobacco from growers when the same is considered necessary for protecting the interests of growers.

Spices Board

The Spices Board was constituted as a statutory body on February 26, 1987 under the Spices Board Act, 1986. The Board has its head office at Kochi and is headed by a Chairman. It has seventeen Regional Offices, thirteen Zonal Offices and thirty-one Field Units. The Board is responsible for the export promotion of 52 spices mentioned in the schedule to Spices Board Act, 1988. The primary functions of the Board are: increasing the production and productivity of small and large cardamom; developing new varieties through selection/ hybridisation for crop improvement; assisting exporters in setting up in-house laboratories; assisting the Government in the development of national quality standards on spices and implementing various export development programmes like promotion of Indian brands abroad.

Export Inspection Council

The Export Inspection Council (EIC), New Delhi, is responsible for the enforcement of quality control and compulsory pre-shipment inspection of various commodities meant for export and notified under the Export (Quality Control and Inspection) Act, 1963. The Council was set up under Section (3) of the Export (Inspection and Quality Control) Act, 1963. It is headed by a Director. The EIC is assisted in its functions by the Export Inspection Agencies(EIAs) located at Chennai, Delhi, Kochi, Kolkata and Mumbai alongwith a network of 41 sub-offices and laboratories to back-up the pre-shipment inspection and certification activities.

Indian Institute of Foreign Trade

The Indian Institute of Foreign Trade (IIFT), New Delhi registered under the Societies Registration Act, 1860, is headed by a Director. The Institute has been conferred 'Deemed University' status and is engaged in the following activities: Training of personnel in modern techniques of international trade; conducting market research, area surveys, commodity surveys related to foreign trade; dissemination of information arising from its research and market studies.

Indian Institute of Packaging

The Indian Institute of Packaging (IIP), Mumbai is registered under the Societies Registration Act, 1860. The main aim of this Institute is to undertake research of raw materials for the packaging industry, to organise training programmes on packaging technology and to stimulate consciousness of the need for good packaging.

Marine Products Export Development Authority

The Marine Products Export Development Authority (MPEDA), Kochi is a statutory body set up under an Act of Parliament (No. 13 of 1972). It became functional from April 20, 1972. The Authority is responsible for the development of the marine products industry with special focus on marine exports. With headquarters at Kochi and field offices in all the Maritime States of India, the MPEDA functions with a Chairman as its CEO. Besides, it has Trade Promotion Offices at Tokyo (Japan) and New York (USA).

Agricultural and Processed Food Products Export Development Authority

The Agricultural and Processed Food Products Export Development Authority (APEDA), New Delhi was also set up under an Act of Parliament of 1986 and entrusted with the task of promoting agricultural exports, including the export of processed foods in value added form. It is headed by a Chairman and functions from its headquarters at New Delhi and five Regional Offices.

Export Promotion Councils

Presently there are twelve EPCs under the administrative control of the Department of Commerce. These Councils are registered as non-profit organisations under the Companies Act/ Societies Registration Act. The Councils perform both advisory and executive functions. They are also the registering authorities for exporters under the Foreign Trade Policy, 2004–09.

OTHER ORGANISATIONS

Federation of Indian Export Organisations (FIEO), New Delhi

The Federation of Indian Export Organisations is an apex body of various export promotion organisations and institutions with its major regional offices at Delhi, Mumbai, Chennai and Kolkata. It provides the content, direction and thrust to India's global export effort. It also functions as a primary servicing agency to provide integrated assistance to its members comprising exporting firms holding recognition status granted by the Government, consultancy firms and service providers. FIEO organises seminars and arranges participation in various exhibitions in India and abroad. The Federation brings out 'FIEO News' for creating awareness among its member exporters and importers.

Indian Council of Arbitration (ICA), New Delhi

The ICA, set up under the Societies Registration Act, promotes arbitration as a means of settling commercial disputes and popularises the concept of arbitration among traders, particularly those engaged in international trade. The Council, a nonprofit service organisation, is a guarantee institution of the Department of Commerce and is eligible for assistance under the Market Development Assistance (MDA) Scheme of the Department. The main objectives of the Council are to promote knowledge and use of arbitration and provide arbitration facilities for amicable and quick settlement of commercial disputes with a view to maintaining a smooth flow of trade, particularly export trade on a sustained and enduring basis.

Indian Diamond Institute (IDI), Surat

The Indian Diamond Institute (IDI) is registered under the Societies Registration Act. It was established in 1978 with the objective of strengthening and improving the availability of trained manpower for the gems and jewellery industry by conducting various Diploma/Post Graduate Diploma level courses in this field. Besides, Sardar Vallabhbhai Jewellery Design and Manufacturing (SVJDM) has been set up in Surat, Gujarat with financial assistance of the Government of India and the Government of Gujarat for providing skilled labour for the Industry.

ADVISORY BODIES

Board of Trade (BoT)

The BoT was set up on May 5, 1989 with a view to provide an effective mechanism to maintain continuous dialogue with trade and industry in respect of major developments in the field of International Trade. It meets at least once in a year. The Commerce and Industry Minister is Chairman of the Board. Its official membership includes Secretaries of the Ministries of Commerce and Industry, Finance (Revenue), External Affairs, Textile; Chairman of Indian Trade Promotion

Organisation (ITPO), Chairman/ MD of Export Credit and Guarantee Corporation of India Limited (ECGC), MD/Exim Bank and Deputy Governor of Reserve Bank of India. The non-official members are Federation of Indian Chamber of Commerce and Industry (FICCI); Associated Chamber of Commerce and Industry (ASSOCHAM), Confederation of Indian Industry (CII), Federation of Indian Export Organisations (FIEO), All India Handloom Farmers Marketing Cooperative Society, representatives of various Trade and Industry sectors, media and other eminent personalities in the field of export and import trade. The broad terms of reference of the Board of Trade are as follows: To advise the Government on policy measures for preparation and implementation of both short-and long-term plans for increasing exports in the light of emerging national and international economic scenario; To review export performance of various sectors, to identify constraints and suggest measures to be taken both by the Government and the industry/trade consistent with the need to maximise export earnings and restrict imports; To examine the existing institutional framework for exports and suggest practical measures for reorganisation/ streamlining it with a view to ensure co-ordinated and timely decision making; to review the policy instrument, package of incentives and procedures for exports and suggest steps to rationalise and channelise incentives to areas where they are needed the most.

Export Promotion Board (EPB)

The EPB functions under the Chairmanship of the Cabinet Secretary to provide policy and infrastructural support through greater coordination amongst concerned Ministries for boosting the growth of exports.

All Ministries directly connected with facilitating foreign trade are represented on the Board by their Secretaries. This includes Secretaries of Department of Commerce; Ministry of Finance; Department of Revenue; Department of Industrial Policy and Promotion; Ministry of Textiles; Department of Agriculture and Cooperation; Ministry of Civil Aviation; Ministry of Surface Transport.

Directorate General of Anti-Dumping and Allied Duties (DGAD)

The formal set up of DGAD was established in April 1998 for carrying out investigations and to recommend, where required, under Customs Tariff Act, the amount of anti-dumping duty/countervailing duty on the identified articles which would be adequate to remove injury to the domestic industry. The Directorate General of Anti-Dumping and Allied Duties is headed by a designated authority of the level of Additional Secretary to the Government of India.

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1. Based on Stiglitz and Walsh, ***Economics***, op. cit., pp. 757–58.
2. Based on Samuelson and Nordhaus, ***Economics,*** op. cit., p. 604.
3. Ibid., pp. 605–07.
4. Ibid., pp. 610–11.
5. Ibid., pp. 611–15.
6. Ibid., p. 615.
7. The discussion is based primarily on Samuelson and Nordhaus, ***Economics,*** op. cit., pp. 613–15 and D. Salvatore, ***International Economics,*** John Wiley & Sons, New Jersey, USA, 2004, pp. 717–22.

8. ***LERMS, Union Budget 1992–93,*** MoF, GoI, N. Delhi.
9. Stiglitz and Walsh, op. cit., p. 757.
10. Samuelson and Nordhaus, op. cit., p. 604
11. D. Salvatore, 2004, op. cit., p.7.
12. ***LERMS,*** op. cit.
13. D. Salvatore, 2004, op.cit., pp. 235–36.
14. Samuelson and Nordhaus, op. cit., p. 601.
15. It means that each external transaction is recorded/entered twice—once as a credit and once as a debit of an equal amount. This is because every transaction has two sides—we sell something and we receive payment for it, similarly we buy something and we have to pay for it (See ***Salvatore,*** op. cit., p. 432).
16. **LERMS**, op. cit.
17. Based on the updated informations available with the **Ministry of Commerce & Industry,** GoI, N. Delhi, May 11 , 2012.
18. Compiled from reports and data of the *RBI, EXIM Bank of India* and the *Gems and Jewellery Export Promotion Council* as referred by the *Economic Survey 2012-13*, MoF, GoI, N Delhi, p. 155.
19. Department of Commerce, Ministry of Commerce and Industry, GoI, N Delhi, April 24, 2013.

16

INTERNATIONAL ECONOMIC ORGANISATIONS & INDIA

*'Oh, East is East and West is West, and never the twain shall meet'. Thus, in the year 1889, wrote Kipling in his famous Ballad of East and West. Little did he know that globalization was only less than a hundred years away.**

- International Monetary System
- Bretton Woods Development
- International Monetary Fund
- World Bank
- Asian Development Bank
- OECD
- World Trade Organisation (WTO)
- WTO Ministerial Conferences
- WTO Negotiations and India
- Looking Beyond DOHA
- Bilateral and Regional Cooperation

** As the Union Finance Minister, P. Chidambram quotes Rudyard Kipling to substantiate the opposite situation in the post-globalisation world in his inaugural Speech on 'The Rise of the East: Implications for the Global Economy' Delivered at Harvard University (April 17, 2013), MoF, GoI, N Delhi.*

INTERNATIONAL MONETARY SYSTEM

The international monetary system (IMS) refers to the customs, rules, instruments, facilities, and organisations facilitating international (external) payments. Sometimes the IMS is also referred to as an international monetary ***order*** or ***regime.***[1] IMS can be classified according to the way in which exchange rates are determined (i.e., fixed currency regime, floating currency regime or managed exchange regime) and the form foreign reserves take (i.e., gold standard, a pure judiciary standard or a gold-exchange standard).

An IMS is considred good if it fulfills the following ***two objectives***[2] in an impartial manner:

(i) maximises the flow of foreign trade and foreign investments, and

(ii) leads to an ***equitable*** distribution of the gains from trade among the nations of the world.

The evaluation of an IMS is done in terms of ***adjustment, liquidity,*** and ***confidence*** which it manages to weild.

Adjustment

It refers to the process by which the balance-of-payment (BoP) crises of the nations of the world (or the member nations) are corrected. A good IMS tries to minimise the cost of BoP and time for adjustment for the nations.

Liquidity

It refers to the amount of foreign currency reserves available to settle the BoP crises of the nations. A good IMS maintains as much foreign reserves to mitigate such crises of the nations without any inflationary pressures on the nations.

Confidence

It refers to the faith the nations of the world should show that the adjustment mechanism of the IMS is working adequately and that foreign reserves will retain their absolute and relative values. This confidence is based on the transparent knowledge information about the IMS.

BRETTON WOODS DEVELOPMENT

As the powerful nations of the world were hopeful of a new and more stable world order with the emergence of the UNO, on the contrary, they were also anxious for a more homogenous world financial order, after the Second World War. The representatives of the USA, the UK and 42 other (total 44 countries) nations met at Bretton Woods, New Hampshire, USA in July 1944 to decide a new international monetary system (IMS). The International Monetary Fund (IMF) and the World Bank (with its first group-institution IBRD) were set up together—popularly called as the ***Bretton***

Woods' twins[3] —both having their headquarters in Washington, DC, USA.

INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) came up in 1944 whose Articles came into force on the December 27, 1945 with the main functions as exchange rate regulation, purchasing short-term foreign currency liabilities of the member nations from around the world, allotting special drawing rights (SDRs) to the member nations and the most important one as the bailor to the member economies in the situation of any BoP crisis.

The ***main functions***[4] of the IMF are as given below:

- (i) to facilitate international monetary cooperation;
- (ii) to promote exchange rate stability and orderly exchange arrangements;
- (iii) to assist in the establishment of a multilateral system of payments and the elimination of foreign exchange restrictions; and
- (iv) to assist member countries by temporarily providing financial resources to correct maladjustment in their balance of payments (BoPs).

The Board of Governors of the IMF consists of one Governor and one Alternate Governor from each member country. For India, Finance Minister is the Ex-officio Governor while the RBI Governor is the Alternate Governor on the Board.

The day-to-day management of the IMF is carried out by the Managing Director who is Chairman *(currently, Ms Christine Lagarde)* of the Board of Executive Directors. Board of Executive Directors consists of 24 directors appointed/elected by member countries/group of countries – is the executive body of the IMF. India is represented at the IMF by an Executive Director (*currently Arvind Virmani*), who also represents three other countries in India's constituency – Bangladesh, Sri Lanks and Bhutan.

India's Quota & Ranking

IMF reviews members' quotas once in five years – last done in December 2010 – here, India consented for its quota increase. After this India's quota (together with its 3 constituency countries) has increased to **2.75** per cent (from 2.44 per cent) and it has become the **8th** (from 11th) largest quota holding country among the **24** constituencies. In absolute terms, India's quota has increased to SDR 13,114.4 million (from SDR 5,821.5 million) which is an increase of app. US $ 11.5 billion or Rs. 56,000 crore).While 25 per cent of the quota is to be paid in ***cash*** (i.e. in 'Reserve' currency), the balance 75 per cent can be paid in ***securities***[5].

Once a member nation has signed the ***EFF*** (Extended Fund Facility) agreement with the IMF, borrowing[6] can be done by the member nation – India signed this agreement in the fiscal 1981-82. ***India has been borrowing*** from the IMF due to critical balance of payment (BoP) situations – once between 1981-84 (SDR 3.9 billion) and next during 1991 (SDR 3.56 billion). All the loans taken from the IMF have been repaid. India is now a *contributor* to the IMF as it participates in the

Financial Transactions Plan (FTP)[7] of the IMF since September 2002 – at this time India was in strong balance of payment situation and in a comfortable forex reserves position.

Current US/EU Financial Crises: Challenges regarding International Payments

The recent financial crises of the US and the EU nations have raised the questions of the challenges of international payments once again. At this crucial juncture, the world seems tossing the idea of a reserved currency for all international payments – as if the famous Keynesian idea of such a currency (Bancor) is going for a kind of revival. The **Bancor** was a supranational currency that John Maynard Keynes and E. F. Schumacher[8] conceptualised in the years 1940-42 which the United Kingdom proposed to introduce after the Second World War. The proposed currency was, viz., be used in international trade as a unit of account within a multilateral barter clearing system, the *International Clearing Union*, which would also have to be founded. The Bancor was to be backed by barter and its value expressed in weight of gold. However, this British proposal could not prevail against the interests of the United States, which at the Bretton Woods conference established the U.S. dollar as world key currency. Milton Friedman[9] the famous US economist insisted that Keynes' theories were incorrect who believed that, 'Inflation was highly destructive and that only monetary policy could control it and that monetary policy is a heavyweight instrument and cannot be used for short-term economic management.'

Since the outbreak of the financial crisis in 2008 ***Keynes's proposal*** has been revived – in a speech delivered in March 2009 entitled *Reform the International Monetary System,* Zhou Xiaochuan, the Governor of the People's Bank of China called Keynes's bancor approach **farsighted** and proposed the adoption of International Monetary Fund (IMF) special drawing rights (SDRs) as a global reserve currency as a response to the financial crisis of 2007–2010. He argued that a national currency was unsuitable as a global reserve currency because of the *Triffin dilemma*[10] - the difficulty faced by reserve currency issuers in trying to simultaneously achieve their domestic monetary policy goals and meet other countries' demand for reserve currency[11]. A similar analysis was articulated in the Report of the United Nation's *Experts on Reforms of the International Monetary and Financial System*[12] as well as in a recent IMF's study[13].

WORLD BANK

The World Bank (WB) Group today consists of ***five*** closely associated institutions propitiating the role of development in the member nations in different areas. A brief account is as follows[14] :

1. IBRD

The International Bank for Reconstruction and Development is the oldest of the World Bank institutions which started functioning (1945) in the area of reconstruction of the war-ravaged regions (World War II) and later for the development of the middle-income and creditworthy poorer economies of the world. Human development was the main focus of the developmental lending with a very low interest rate (1.55 per cent per annum)—the areas of focus being agriculture, irrigation,

urban development, healthcare, family welfare, dairy development, etc. It commenced lending for India in 1949.

2. IDA

The International Development Agency (IDA) which is also known as the *soft window* of the WB was set up in 1960 with the basic aim of developing infrastructural support among the member nations, long-term lending for the development of economic services. Its loans, known as ***credits*** are extended mainly to economies with less than $895 per capita income. The credits are for a period of 35–40 years, ***interest***-free, except for a small charge to cover administrative costs. Repayment begins after a 10-year grace period. There was no human angle to its lending. But now there remain no hard and fast differences between the purposes for the IBRD and IDA lending.

Every year developing nations make enough diplomatic attempts to carve out maximum loan disbursal for themselves. India had been the ***biggest beneficiary*** of the IDA support. The total support (IBRD + IDA) for India had been $ 91.81 billion till date[15].

3. IFC

The International Finance Corporation (IFC) was set up in 1956 which is also known as the *private arm* of the WB. It lends money to the private sector companies of its member nations. The interest rate charged is commercial but comparatively low. There are many attractive features of IFC's lending. It finances and provides advice for private public ventures and projects in partnership with private investors and, through its advisory work, helps governments of the member nations to create conditions that stimulate the flow of both domestic and foreign private savings and investment.

It focuses on promoting economic development by encouraging the growth of productive enterprises and efficient capital markets in its member countries. It participates in an investment only when it can make a special contribution that complements the role of market investors (as a Foreign Financial Investor (FFI). It also plays a catalytic role, stimulating and mobilising private investment in the developing world by demonstrating that investments there too can be profitable.

We have seen a great upsurge in the IFC investments in India which has undoubtedly strengthened the foreign investors' confidence in the Indian economy.

4. MIGA

The Multilateral Investment Guarantee Agency (MIGA), set up in 1988 encourages foreign investment in developing economies by offering insurance (guarantees) to foreign private investors against loss caused by ***non-commercial (i.e. political) risks,*** such as currency transfer, expropriation, war and civil disturbance. It also provides technical assistance to help countries disseminate information on investment opportunities.

5. ICSID

The International Centre for Settlement of Investment Disputes (ICSID), set up in 1966 is an investment dispute settlement body whose decisions are binding on the parties. It was established

under the 1966 ***Convention on the Settlement of Investment Disputes between States and Nationals of Other States.*** Though recourse to the centre is voluntary, but once the parties have agreed to arbitration, they cannot withdraw their consent unilaterally. It settles the investment disputes arising between the investing foreign companies and the host countries where the investments have been done.

India is not its member (that is why the Enron issue was out of its preview). It is believed that being signatory to it encourages the foreign investment flows into an economy but risks independent sovereign decisions, too.

BIPA

As part of the Economic Reforms Programme initiated in 1991, the foreign investment policy of the Government of India was liberalised and negotiations undertaken with a number of countries to enter into *Bilateral Investment Promotion & Protection Agreement (BIPAs)* in order to ***promote and protect on reciprocal basis investment of the investors***. Government of India have, so far, *(as by July 2012)* signed BIPAs with 82 countries out of which 72 BIPAs have already come into force and the remaining agreements are in the process of being enforced.[16] In addition, agreements have also been finalised and/or being negotiated with a number of other countries.

The **objective** of the BIPA is to promote and protect the interests of investors of either country in the territory of other country. Such agreements increase the comfort level of the investors by assuring a minimum standard of treatment in all matters and provides for justifiability of disputes with the host country *(it should be noted here that India is not a member of the World Bank group's body, the ICSID, serving the same purpose. BIPA is India's version. While the former is a multilateral body, the latter is a bilateral one).*

ASIAN DEVELOPMENT BANK

The Asian Development Bank (ADB), with an international partnership of 63 member countries, was established in 1966 and has headquarters at Manila, the Philippines. India is a founder member of ADB. The Bank is engaged in promoting economic and social progress of its developing member countries in the Asia-Pacific region. Its principal functions are as follows:

- (i) to make loans and equity investments for the economic and social advancement of its developing member countries;
- (ii) to provide technical assistance for the preparation and execution of development projects and programmes and advisory services;
- (iii) to respond to the requests for assistance in coordinating development policies and plans in developing member countries; and
- (iv) to respond to the requests for assistance and coordinating development policies and plans of developing member countries.

India's subscription to the Bank's capital stock is 7.190 per cent with a voting power of 6.050 per cent (as per the *ADB Annual Report, 2010*), ***as quoted by India 2013.***

India started borrowing from ADB's Ordinary Capital Resources(OCR) in 1986. The Bank's lending has been mainly in the Energy, Transport and Communications, Finance, Industry and Social Infrastructure sectors.

The Bank has extended technical assistance to India in addition to loans from its OCR window. The technical assistance provided include support for institutional strengthening, effective project implementation and policy reforms as well as for project preparation.

India holds the position of Executive Director on the Board of Directors of the Bank—its Constituency comprises India, Bangladesh, Bhutan, Lao PDR and Tajikistan. The Finance Minister is India's Governor on the Board of Governors of the Asian Development Bank and Secretary (EA) is the Alternate Governor.

OECD

The roots[17] of the Organisation for Economic Co-operation and Development (OECD), Paris, go back to the rubble of Europe after World War II. Determined to avoid the mistakes of their predecessors in the wake of World War I, European leaders realised that the best way to ensure lasting peace was to encourage co-operation and reconstruction, rather than punish the defeated.

The Organisation for European Economic Cooperation (OEEC) was established in 1947 to run the US-financed **Marshall Plan** for reconstruction of a continent ravaged by war. By making individual governments recognise the interdependence of their economies, it paved the way for a new era of cooperation that was to change the face of Europe. Encouraged by its success and the prospect of carrying its work forward on a global stage, Canada and the US joined OEEC members in signing the new OECD Convention on December 14, 1960. The Organisation for Economic Co-operation and Development (OECD) was officially born on September 30, 1961, when the Convention entered into force.

Other countries joined in, starting with Japan in 1964. Today, **34** OECD member countries worldwide regularly turn to one another to identify problems, discuss and analyse them, and promote policies to solve them. The track record is striking. The US has seen its national wealth almost ***triple*** in the five decades since the OECD was created, calculated in terms of gross domestic product per head of population. Other OECD countries have seen similar, and in some cases even more spectacular, progress.

There are many countries that a few decades ago were still only minor players on the world stage – China, India and Brazil have emerged as new economic giants. Most of the countries that formed part of the former Soviet bloc have either joined the OECD or adopted its standards and principles to achieve the common goals. Russia is negotiating to become a member of the OECD, and now the organisation has close relations with Brazil, China, India, Indonesia and South Africa through its "enhanced engagement" programme. Together with them, the OECD brings around its table **40** countries that account for **80%** of world trade and investment, giving it a pivotal role in addressing the challenges facing the world economy.

Enlargement and Enhanced Engagement:

In May 2007, OECD countries agreed to invite Chile, Estonia, Israel, Russia and Slovenia to open discussions for membership of the Organisation and offered enhanced engagement to Brazil, China, India, Indonesia and South Africa.

Chile became a member of the Organisation on May 7, 2010, Slovenia became a member on July 21, 2010 and Israel became a member on September 7, 2010. On December 9, 2010, Estonia became a member, once necessary formalities, including parliamentary approval, were completed.

While enhanced engagement is distinct from **accession** to the OECD, it has the potential in the future to lead to membership. The approval of so-called 'road maps' marked the start of accession talks with Chile, Estonia, Israel, Russia and Slovenia. The accession procedure is complex and can be long, as it involves a series of examinations to assess a country's ability to meet OECD standards in a wide range of policy areas. This makes it difficult to bring on board more than a small number of new members at the same time.

WORLD TRADE ORGANISATION (WTO)

The World Trade Organisation (WTO) came into being as a result of the evolution of the multilateral trading system starting with the establishment of the General Agreement on Tariffs and Trade (GATT) in 1947. The protracted Uruguay Round negotiations spanning the period 1986–1994, which resulted in the establishment of the WTO, substantially extended the reach of multilateral rules and disciplines related to trade in goods, and introduced multilateral rules applicable to trade in agriculture (Agreement on Agriculture), trade in services (General Agreement on Trade in Services—GATS) as well as Trade Related Intellectual Property Rights (TRIPS). A separate understanding on WTO dispute settlement mechanism (DSU) and trade policy review mechanism (TPRM) was also agreed upon.

WTO and India

India is a founder-member of both GATT and WTO. The WTO provides a rule based, transparent and predictable multilateral trading system. The WTO rules envisage non-discrimination in the form of National Treatment and ***Most Favoured Nation (MFN)*** treatment to India's exports in the markets of other WTO Members. National Treatment ensures that India's products once imported into the territory of other WTO Members would not be discriminated vis-à-vis the domestic products in those countries. MFN treatment principle ensures that members do not discriminate among various WTO Members. If a Member country believes that the due benefits are not accruing to it because of trade measures by another WTO Member, which are violative of WTO rules and disciplines, it may file a dispute under the Dispute Settlement Mechanism (DSM) of the WTO. There are also contingency provisions built into WTO rules, enabling member countries to take care of exigencies like balance of payment problems and situations like a surge in imports. In case of unfair trade practices causing injury to the domestic producers, there are provisions to impose Anti-Dumping or Countervailing duties as provided for in the Anti-Dumping Agreement and the Subsidies and Countervailing Measures Agreement.

WTO Membership

The present strength of WTO membership[18] is 159. Against the backdrop of the challenging world economic climate *four countries* acceded to the WTO at the 8th Ministerial Conference, Geneva in December 2011 – the Russian Federation, Samoa, Montenegro and Vanuatu. Russian Federation joined it after an 18-year accession process – it applied to join the WTO in 1993 – then they entered a period of 18 years of bilateral negotiations with GATT/WTO members concerning goods and services and various systemic obligations. Significant divergence of views between Russia and the EU, US and Georgia respectively were the source of repeated setbacks in the accession process.

WTO MINISTERIAL CONFERENCES

The highest decision-making body of the WTO is the Ministerial Conference, which has to meet at least once every two years. It brings together all members of the WTO, all of which are countries or separate customs territories. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements. Since the coming into being of the WTO in January 1995, eight Ministerial Conferences have been held, namely, ***Geneva*** (December 15–17, 2011); ***Geneva*** (30 November 30–2, December 2009); ***Hong Kong*** (December 13–18, 2005); ***Cancún*** (September 10–14, 2003); ***Doha*** (November 9–13, 2001); ***Seattle*** (November 30 – December 3, 1999); ***Geneva*** (May 18–20, 1998); ***Singapore*** (December 9–13 1996). The next (9^{th}) Ministerial Conference will be ***Bali*** (December 3–6, 2013).

WTO NEGOTIATIONS AND INDIA

The Doha Round of trade negotiations in the WTO, effectively, made very little progress after 2008. Throughout 2009 and 2010, discussions continued but no headway was made on any substantive issue in the negotiations. However, the subject featured on the agenda of almost every major international meeting and there were strong affirmations of political support for an early conclusion of the Doha Round. Discussions continued in Geneva during March and April 2011, in a variety of formats. Reports on each area of the negotiations were issued on April 21, 2011. These documents provided an overview of the status of negotiations covered in the Doha Development Agenda. While they indicated significant progress in many areas, they also captured the wide gaps remaining on many issues.

The focus then shifted to the possibility of selecting some issues for finalisation as an ***'early harvest'*** in time for the Eighth Ministerial Conference of the WTO in December 2011. It began with an attempt to select issues of particular importance to least developed countries (LDCs). However, these attempts did not meet with any success and proved not only unproductive but very divisive as well. Members could not agree on the issues to be included and sought to selectively bring in various issues of commercial interest to them. Gradually, as members brought in non-LDC issues, the discussion veered away from the LDC issues. The LDC issues include:

(i) duty free quota free (DFQF) market access;

(ii) the rules of origin for DFQF market access;

(iii) LDC waiver in services; and

(iv) issues relating to cotton (domestic and export subsidies for cotton and tariffs).

Some of the issues suggested in addition for an **'LDC plus'** package were trade facilitation and the export competition pillar of the agriculture negotiations. There was, however, little progress in arriving at a consensus on the elements of the early harvest package. The LDCs made it clear that if the LDC package was not delivered at the December 2011 Ministerial Conference, they would be very disappointed. The African Group, the African-Caribbean-Pacific Group, and other groups of developing countries supported an effort to harvest an LDC package for the Conference. India too, supported this stand.

I n *October–November 2011,* concerted efforts were made by some of the developed country members of the WTO to use the G20 Leaders Summit in November 2011 to advance an agenda for the ***Eighth WTO Ministerial Conference*** scheduled to be held in **Geneva** in December 2011. Specifically, they wanted the following things:

(i) to set the stage for plurilateral agreements on selected issues in the WTO negotiations (rather than multilateral agreements);

(ii) to get WTO members' on abjuring the use of export restrictions; and

(iii) to introduce new issues for negotiation, namely climate change, energy security, and food security.

The weeks preceding the Eighth WTO Ministerial Conference saw hectic activity in the WTO as some members attempted to put various issues on the agenda for ministerial decision. These proposals, however, did not receive support amongst WTO members. At the ***Eighth Ministerial Conference*** from 15 to 17 December 2011, ministers adopted a number of decisions on intellectual property (IP), electronic commerce, small economies, LDCs' accession, a services waiver for LDCs, and trade policy reviews.

A number of members expressed *strong reservations* about plurilateral approaches. Many members stressed that any different approaches in the work ahead should conform to the Doha mandate, respect the single undertaking, and be truly multilateral, transparent, and inclusive. In looking at future work, a large number of ministers stressed the centrality of development. Many underlined the need to give priority to issues of interest to LDCs, including cotton. Many mentioned the importance of all three pillars in the agriculture negotiations. Many also mentioned trade facilitation, special and differential (S&D) treatment, S&D monitoring mechanism and NTMs. In an *unprecedented display of unity*, a coalition of more than a hundred developing countries, including India, Brazil, China, and South Africa, met on the sidelines of the Conference and issued a declaration emphasizing the development agenda. They roundly criticized suggestions for plurilateral agreements to replace decision making by multilateral consensus. Critics declared the Doha Round a dead horse now.

Fifth Trade Policy Review (TPR) of India

In order to promote transparency and provide better understanding of the trade policies and practices of its members, the WTO has ***a mechanism*** for regular review of their trade policies. Depending upon its share in world trade, each member's trade policy is reviewed by the WTO at fixed periodic

intervals. India's TPR is carried out every *four* years.

The TPR offers an opportunity to other WTO members to ask questions and raise concerns on different aspects of policies and practices of the country under review. The Fifth TPR of India was held on 14 and 16 September 2011 in the WTO. Before the meeting, the WTO Secretariat circulated a compilation of India's written replies to 886 advance questions raised by 26 WTO members.

During the review, most of the members *commended* the resilience of the Indian economy that smoothly withstood the adverse effects of global financial crisis without taking recourse to protectionist measures. Members appreciated India for using its trade policy to promote sustainable development and inclusive growth. Members also noted India's positive engagement in *Doha Round negotiations*. Some of the members, notably the US, raised concerns in certain areas, namely tariffs and duties, licensing and restrictions, trade defence measures (anti-dumping), government procurement, incentive schemes to promote investments and exports and protect agriculture, tariff protection on agriculture, services and investments. Responses to the issues raised were provided in India's **Closing Statement** on September 16, 2011 which are as follows:

Openness of India's Trade Regime

Questions were asked about the openness of India's trading regime. In response India pointed out that year after year, India's imports had outpaced exports. In terms of percentage of GDP, the countryfs merchandise trade deficit is one of the highest in the world. India has been autonomously reducing its tariffs over the years. The simple average most favoured nation (MFN) tariff rate declined from 15.1 per cent in 2006-7 to 12 per cent in 2010-11. Both the average agricultural and industrial average tariffs have declined over time. The tariffs on 71 per cent of Indiafs tariff lines are between 5 and 10 per cent.

Gap between Rates on Agri Products

Some members mentioned the large gap between India's bound and applied rates on agricultural products. India responded that the large gap reflected India's steady and continued autonomous tariff liberalization. During the four years since the last TPR, the tariffs on some agricultural commodities had to be adjusted in the face of high volatility in food prices. In most cases, tariffs have been brought down and have stayed down. In a few instances, they have been raised again but never above their original levels.

Export Incentives

Questions were asked about export promotion schemes. It was explained that India's export promotion schemes are based on the concept of duty neutralization and providing a level playing field. These schemes are reviewed regularly.

FDI Policy

To a number of questions on FDI policy, India explained that the continuing thrust, during the period since India's last TPR in 2007, has been on making the FDI policy more liberal and investment

friendly. The FDI guidelines have been significantly rationalized, simplified, and consolidated, with the aim of providing a single policy platform for reference of foreign investors. Several new sectors, such as petroleum and natural gas and civil aviation were either opened up to foreign investment or significantly liberalised during this period. Efforts were also being made to streamline and simplify the business environment and make regulations conducive to business.

IPRs

On questions related to India's IP policies, India replied that a number of initiatives have been taken to enhance IP protection and enforcement. The changes proposed in the Copyright and Trademark Acts would enhance protection to intellectual property rights (IPRs) in digital technology particularly with regard to the dissemination of protected material over digital networks. These have been supplemented by administrative as well as judicial measures to strengthen the IPR regime. The provisions on IP protection in these laws are further supplemented by broader measures to prevent the import of goods involving copyright piracy and counterfeit trademarks. Another initiative taken by Indian customs is the facility for online registration by the right holders through the web-based Automatic Recordation and Targeting for IPR Protection System.

Government Procurement

On this subject, India explained that the procurement of high tech items and high value tenders, above US$ 50,000 is generally open to international bidders. Major reforms are on the anvil for increasing coverage, improving transparency and efficiency, and better enforcement, which are triggered by domestic concerns relating to enhancing the value for money. An omnibus procurement law applicable to the entire country and to all procuring entities, including public-sector enterprises, is being deliberated upon.

Sanitary & Phyto-sanitary (SPS) and Technical Barriers to Trade (TBT)

In response to question on India's SPS and TBT measures, India explained that specific trade concerns raised against India have been largely addressed. Regulations adopted in the past have been on the basis of scientific risk analysis.

Export Restrictions

There were some questions on India's use of export restrictions. India responded that export restrictions have been used on some occasions for purposes of domestic supply management, but these have been purely on a temporary basis. The ban on the export of rice and wheat had to be extended in 2009 due to a dislocation in production and again in 2010 due to the severest drought in the country in the last forty years. However, the export of wheat and non-basmati rice is now completely free. The export of basmati rice is and has always been free. Restrictions on cotton exports were imposed for only a brief period last year. Cotton yarn exports have been made completely free. Similarly, cotton is also freely exportable.

LOOKING BEYOND DOHA

At the Eighth Ministerial Conference (MC8) of the WTO in Geneva, December 15–17 , 2011 three Working Sessions were held in parallel (the NGOs were not allowed to take part in it), directed to ***three*** topics:

i. Importance of the Multilateral Trading System and the WTO;

ii. Trade and Development; and

iii. The Doha Development Agenda negotiations.

As had been expressly stated in the run-up to the **MC8** both from the WTO, from capitals, and in media reports, the ***Doha Round negotiations generally had come to an impasse.*** The impasse was made especially clear from the outcome of the so-called *Easter Package* in April 2011 – which comprised the collected reports of the WTO negotiating bodies in all the different areas involved in the Doha Round negotiations. *Pascal Lamy*, Director General of the WTO, said in a statement March 29, 2011, that the *'biggest stumbling block' was what is called 'NAMA sectorals'*. This is about proposals for major trading countries, including emerging economies, to allow duty-free or lower-than-normal duty on imports in particular sectors within the non-agricultural market access (NAMA), negotiations.

That assessment was also made very clear in the statement by the US Trade Representative at the MC8, '*... the current impasse in many ways comes down to one single, vexing quandary: the WTO has not come to terms over core questions of shared responsibilities among its biggest and most successful Members. The world has changed profoundly since the negotiations began a decade ago, most obviously in the rise of the emerging economies. The results of our negotiations thus far do not reflect this change, and yet they must if we are to be successful.'*

TRIPS issues had already earlier in 2011 been placed in what was called a 'slow lane' in the negotiations. For the 'Easter package' in April 2011, the status of the **GI** (Geographic Indication) issues and of the TRIPS/CBD issue was reported by the Director-General, document TN/C/W/61 dated April 21, 2011. On the TRIPS/CBD issue a submission was made in the context of the Easter Package from a number of WTO Members including *Brazil, India*, and *China* in April 2011, requesting a revised version of the TRIPS Agreement calling for *disclosure of origin of genetic resources* and/or associated *Traditional Knowledge* involved in patent applications. Noteworthy in that this submission was not sponsored by the EU and Switzerland, two of the original sponsors of the 2008 'mini-ministerial' proposal for a TRIPS package on GIs and disclosure of origin of genetic resources. Nevertheless, of the decisions taken at the MC8, two are TRIPS-related:

(i) extending until the next Ministerial Conference, to be held in 2013, the moratorium on what is called "non-violation omplaints" under the TRIPS Agreement; and

(ii) instructing the TRIPS Council to extend, under TRIPS Article 66.1, the transition period expiring June 30, 2013, for LDCs, for implementing the TRIPS Agreement.

Future Directions

At the MC8 the WTO members acknowledged the concerns on the global economic climate and

agreed that:

(i) There is no credible alternative to the rules based multilateral trading system; and

(ii) Protectionist trade measures must be avoided.

The Chairman, in his summary report, stressed that the ***future work*** of the WTO must give priority to the development issues of LDCs, in particular cotton. Further, that the WTO needs to take into account the views of all its members. Despite the uncertainty surrounding the Doha negotiations, the MC8 has sent a clear message that the WTO remains relevant and important to world trade, as illustrated by the accessions of the Russian Federation, Montenegro, Samoa and Vanuatu. In his concluding remarks, Pascal Lamy stressed that despite these worrying economic times, *'don't chop off the branch you're sitting on…'* (a Russian proverb). The multilateral trading system is vital to world economic stability. *Finally*, the Doha negotiation impasse has led to members exploring new approaches to negotiating. Members were urged to have political courage and goodwill in concluding the DOHA round. The world is waiting for the next and the *Ninth Ministerial Coneference* of the WTO, scheduled to take place in **Bali** (December 3–6 , 2013).

BILATERAL AND REGIONAL COOPERATION

India has always stood for an open, equitable, predictable, non-discriminatory, and rule-based international trading system. Considering that regional and bilateral trade and economic cooperation agreements serve as building blocks towards achieving the multilateral trade liberalisation objective, India is actively engaging in regional and bilateral negotiations with her trading partner countries/blocs to diversify and expand the markets for its exports. Some of the recent developments related to major *Free Trade Agreements (FTAs)* are the following:

(i) India-Japan Comprehensive Economic Partnership Agreement (CEPA)

(ii) India-Malaysia Comprehensive Economic Cooperation Agreement (CECA)

(iii) India-ASEAN Trade in Goods Agreement

(iv) India-EU Trade and Investment Agreement Negotiations

(v) India-European Free Trade Association (EFTA)

(vi) BTIA (Iceland, Norway, Liechtenstein, and Switzerland)

(vii) India-New Zealand FTA/CECA

(viii) India-Australia CECA

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1. D. Salvatore, ***International Economics,*** John Wiley & Sons, New Jersey, USA, 2005, pp. 737–38; Samuelson and Nordhaus, ***Economics,*** Tata McGraw-Hill, N. Delhi, 2005, pp. 609–12.
2. D. Salvatore, op. cit., p. 738.
3. For the new international monetary system, basically two plans were presented in the meeting—one by the US delegation led by ***Harry D. White*** (of the US Treasury) and the British delegation led by ***John Meynard Keynes.*** It was the US plan which was ultimately agreed upon.

   J.M. Keynes had proposed a more impartial, practical and over-arching idea via his plan at Bretton Woods. His suggestions

basically included three things:

(i) Proposal to set up an International Clearing Union (ICU), a central bank of all central banks, with its own currency (Keynes named this currency ***'bancor'***)—to mitigate the balance of payment crises of member nations.

This bank was supposed to penalise (***no such provision in the IMF***) the countries holding trade surpluses (with a global tax of one per cent per month) on the ground that such countries were keeping world demand low by under-purchasing the products produced by other countries. The corpus collected via this tax was to be used to maintain an international buffer stock of primary goods (i.e., food articles)—to be used in the periods of food shortages among the member nations. (***In place, under the IMF provisions trade deficit countries are penalised***.)

(ii) For the reconstruction of war-devastated Europe, a ***fund*** was to be set up, on the basis of this plan for Relief and Reconstruction (in place of it the US-sponsored ***Marshall Plan*** took care of the needs of Europe).

(iii) There was a proposal of creating Commodity Buffer Stock to be operated by an International Trade Organisation (ITO). This stock of primary goods was to be used to stabilise their prices in the international market.

The operation of this ITO making purchases when the world prices were low and selling when the prices became high. The buffer stock operations, however, were to be helpful to the poor countries, Keynes was primarily interested in stabilising the input prices of the rich countries. (***Though the charter of the ITO was drawn up and other formalities completed, it was never born because of US opposition***.) ***For further readings see*** D. Salvatore, ***International Economics,*** op. cit., pp. 742–43; B. Dasgupta, ***Globalisation : India's Adjustment Experience,*** Sage, N. Delhi, 2005, p. 48.

4. ***Basic Facts About the United Nations,*** UN, New York, 2000, pp. 55 & 137.
5. These securities are non-interest bearing note purchase agreements issued by the RBI which can be encashed by the IMF anytime as per its requirement. They do not entail any cash outgo unless the IMF calls upon India to encash a portion of these nots. The 'Reserve' (paid in 'cash') asset portion of the quots is counted as a part of country's 'Reserves'.
6. FTP is the mechanism of the IMF through which it finances/repays its operations – member nations contribute money into it from their 'quota resources' on which they get 'interest'.
7. Such facility from it is available once the member country has signed the agreement with the IMF called as the Extended Fund Facility (EFF). Popularly, this is known as the ***'Conditionalities of the IMF'*** under which India started its Economic Reform Programme in 1991-92 once it borrowed from the IMF in the wake of the BoP crisis of 1990–91.
8. ***E. F. Schumacher,*** *Multilateral Clearing Economica,* New Series, Vol. 10, No. 38 (May, 1943), pp. 150-165.
9. ***M. Friedman.,*** (1968) *The American Economic Review,* Vol. 58, No. 1, 1-17.
10. ***Zhou Xiaochuan,*** (2009). 'Reform the International Monetary System', BIS Review, Bank of International Settlements, Basel, Switzerland, 28th Nov. 2011.
11. ***Zhou Xiaochuan,*** *Financial Times, 12th Dec. 2011.*
12. Recommendations by the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system, UNO, 20th March, 2009.
13. ***Reserve Accumulation and International Monetary Stability,*** *IMF,* Washington DC, 13th April, 2010.
14. Based on ***Basic Facts About the United Nations,*** op. cit., pp. 52–55; ***India 2004-2013,*** Pub. Div., GoI, N. Delhi.
15. ***India 2013,*** Pub. Div., GoI, N. Delhi, p. 415
16. ***Ministry of Commerce & Industry,*** GoI, N. Delhi, as on May 12 2012.
17. ***India 2012,*** op. cit., p. 418
18. As per the ***WTO*** website, 24th March, 2013.

17

TAX STRUCTURE IN INDIA

*Through taxes, government in reality decides how to draw the required resources from the nation's households and businesses for public purposes – the money raised so is the 'vehicle' by which real resources are transferred from private goods to public goods.**

- Tax
- Methods of Taxation
- A Good Tax System
- Methods of Expenditure
- Value Added Tax
- Need of VAT in India
- Goods and Services Tax
- Additional Excise Duty
- CST Reforms
- Service Tax
- Voluntary Compliance Encouragement Scheme
- Commodities Transaction Tax (CTT)
- Securities Transaction Tax (STT)
- Capital Gains Tax
- Investment Allowance
- Collection Rates
- Tax Expenditure
- 14th Finance Commission

** See Paul A. Samuelson and William D. Nordhaus, Economics, The McGraw-Hill Company, New York, USA, 2005, pp. 327-340. Also see Joseph E. Stiglitz and Carl E. Walsh, Economics, W. W. Norton, New Yok, USA, 4th Edition, 2006, pp. 380-86.*

TAX

Modern economics ***defines*** tax as a mode of income redistribution.[1] There might be other ways also to look at it—the usual meaning of tax people think is that a tax is imposed by the government to fulfill its important obligations on the expenditure front.[2] We may take an example to see how taxes redistribute income:

Suppose an economy has a flat rate of income tax, i.e., 30 per cent. Just see the impact of this tax on the income disparity of two people A and B earning Rs. 50,000 and Rs. 80,000, respectively—

We see here that the income disparity of ‘30,000 comes down to Rs. 19,000 after payment of the tax —the income has been re-distributed at the *first* level due to tax.

Individual	*Income* (Rs.)	*Income disparity before* tax (Rs.)	*Income after paying* tax (Rs.)	*Income disparity after* tax (Rs.)
A	50,000		35,000	
		30,000		19,000
B	80,000		54,000	

Now the money the government has got by tax collection, i.e., Rs. 39,000 (Rs.15,000 + Rs. 24,000)

Now the money the government has got by tax collection, i.e., Rs. 39,000 (Rs. 15,000 + Rs. 24,000) will be spent on different sectors—infrastructure, education, health etc—which will provide services to each and everybody alike. Here income is re-distributed at the *secondary* level. Consider a person who pays income tax, but does not take services of government schools for his children’s education, nor goes to the government hospitals for medical services and compare him with a person who has no option other than the government schools and the hospitals—the higher tax payer getting no government services and a lower tax payer getting all the services. Here income looks re-distributed from the consumption side.

Incidence of Tax

The point where tax looks being imposed is known as the incidence of Tax—the event of tax imposition.[3]

Impact of Tax

The point where tax makes its effect felt is known as the impact of tax—the after effect of tax imposition.[4]

Direct Tax

The tax which has incidence and impact both at the same point is the direct tax—the person who is hit, the same person bleeds.[5] As for example income tax, interest tax, etc.

Indirect Tax

The tax which has incidence and impact at the different points is the indirect tax—the person who is hit does not bleed[6] someone else bleeds. As, for example, excise, sales tax, etc which are imposed on either producers or the traders, but it is the general consumers who bear the burden of tax.

METHODS OF TAXATION

There are three methods of taxation prevalent in economies with their individual merits and demerits —

Progressive Taxation

This method has increasing rates of tax for increasing value or volume on which the tax is being imposed.[7] Indian income tax is a typical example of it. The idea here is less tax on the people who earn less and higher tax on the people who earn more—classifying income earners into different slabs. This method is believed to discourage more earnings by the individual to support low growth and development unintentionally. Being poor is rewarded while richness is punished. Tax payers also start evading tax by showing lower unreal income. But from different angles this tax is pro-poor and taxes people according to their affordability/ sustainability. This is the most popular taxation method in the world and a populist one, too.

Regressive Taxation

This is just opposite to the progressive method having decreasing rates of tax for increasing value or volume on which the tax is being imposed.[8] There are not any permanent or specific sectors for such taxes. As a provision of promotion, some sectors might be imposed with regressive taxes. As for example, to promote the growth and development of the small scale industries, India at one time had regressive excise duty on their productions—with increasing slabs of volume they produced, the burden of tax used to go on decreasing.

This method while appreciated for rewarding the higher producers or income-earners, is criticised for being more taxing on the poor and low-producers. This is not a popular mode of taxation and not as per the spirit of the modern democracies.

Proportional Taxation

In such taxation method, there is neither progression nor regression from the rate of taxes point of view. Such taxes have fixed rates for every level of income or production, they are neutral from the poor or rich point view or from the levels of production point of view.[9] Usually, this is not used by the economies as an independent method of taxation. Generally, this mode is used as a complementary method with either progressive or regressive taxation. If not converted into proportional taxes, every progressive tax will go on increasing and similarly every regressive tax will decrease to zero,

becoming completely a futile tax methods. That is why every tax, be it progressive or regressive in nature, must be converted into proportional taxes after a certain level.

A GOOD TAX SYSTEM

What are the characteristics of a good tax system? There has always been a debate among economists and policymakers on the issue of design of the tax system. Taxation in developing economies has been even more debated as the trade-off assessment generates enough controversy. Main debatable issues in the design of a tax system are whether progressive or regressive taxation, direct tax or indirect tax collections should be higher, whether revenue deficit is better, etc. The controversies set apart, there is a broad consensus on five ***principles***[10] of a good tax system, among economists and the policy making experts:

(i) Fairness

Though fairness (i.e., the first criteria of a good tax system) is not always easy to define, economists suggest inclusion of two elements in the tax system to make it fair namely, ***horizontal equity*** and ***vertical equity.*** Individuals in identical or similar situations paying identical or similar taxes is known as ***horizontal equity.*** When 'better off' people pay more taxes it is known as ***vertical equity***.

(ii) Efficiency

Efficiency of a tax system is its potential to affect or interfere the efficiency of the economy. A good tax system raises revenue with the least cost on the taxpayers and least interference on the allocation of resources in the economy. The tax system affects the economic decisions of individuals and groups by either encouraging or discouraging them to save, spend, invest, etc. Taxes can improve efficiency of economy—taxes on pollution or on smoking give revenue to the government and serves broader social purposes, too. This is known as the ***double dividend*** of a tax.

(iii) Administrative Simplicity

This is the third criterion which includes factors like computation, filing, collection, etc. of the taxes that all should be as simple as possible. Simplicity checks tax evasion too. Tax reform in India has simplification of tax as its major plank—also recommended by the Chelliah Committee.

(iv) Flexibility

A good tax system has the scope of desirable modifications in it if there is any such need.

(v) Transparency

How much tax taxpayers are actually paying and what are they getting against it in the form of the public services should be ascertainable i.e. the transparency factor.

METHODS OF EXPENDITURE

Similar to the methods of taxation the modes of government expenditure are also of three types —Progressive, Regressive and Proportional.[11]

At first instance it seems that as a country achieves better levels of development, sectoral and the item-wise expenditure of the economy must have decreasing trends. But practical experience shows that the level of expenditure needs enhancement everyday and economy always needs more and more revenues to fulfill the rising expenditures. That is why for economies the best form of government expenditure is the progressive expenditure.

The best way of taxation is progressive and the best way of government expenditure is also progressive and they suit each other beautifully. Most of the economies around the world are having progressive taxation with progressive expenditure.

VALUE ADDED TAX

The value added tax (VAT) is a method of tax collection as well as name of a state level tax (***at present***) in India. A tax collected at every stage of value addition, i.e., either by production or distribution is known as value added tax.[12] The name itself suggests that this tax is collected on the value addition (i.e., production).

Production of goods or services is nothing but stages of value additions where production of goods is done by the industrialists or manufacturers. But these goods require value addition by different service providers/ producers (the agents, the wholesalers and the retailers) before they reach the consumers. From production to the level of sale, there are many points where value is added in all goods. VAT method of tax collection is different from the non-VAT method in the sense that it is imposed and collected at different points of value addition chain, i.e., ***multi-point tax collection***. That is why there is no chance of imposing tax upon tax which takes place in the non-VAT method —***single point tax*** collection. This is why VAT does not have a 'cascading effect' on the prices of goods it does not increase inflation—and is therefore highly suitable for an economy like India where due to high level of poverty large number of people lack the market level purchasing capacity. It is a pro-poor tax system without being anti-rich because rich people do not suffer either.

NEED OF VAT IN INDIA

Over 150 nations in the world have implemented the VAT system of taxation regarding collecting their indirect taxes. There have been valid reasons why India should move towards the VAT method of tax collection. We may see some of the major reasons:[13]

(i) Due to single point tax collection, Indian indirect tax collection system was price-increasing (having *cascading effect* on the price) which was highly detrimental to the poor masses. Implementation of VAT will improve the purchasing capacity and so living standard of the

poor people.[14]

(ii) India is having a federal political system where side by side the central government states have also been given power to impose taxes and collect them. At the central level, there had been uniformity of taxes for the economy. But there was no 'uniformity' at the state level taxes (i.e., state excise, sales tax, entertainment tax, etc.). This was detrimental to the development of a single market for Indian economy as a whole. India bassically had many markets but no Indian market as such. To bring in uniformity at the state-level taxes, VAT was a necessary step in India.

(iii) With the process of economic reforms, India moved towards market economy. And for this, firstly India needed to have a single market. Without uniformity at the state level taxes (***uniform VAT***) this was not possible.

(iv) Indian federal design has resulted in economically weaker states and stronger centre. As VAT increases the total tax collection (experience of the world suggests so) it was fit to be implemented at the state level.

(v) India has been a country of high level tax evasion. By implementing VAT method of indirect tax collection, it becomes almost impossible to go for large scale tax evasion. To prove one's level of value addition, the purchase invoice/receipt is a must which ultimately makes it cross-check the level of production and sale in the economy.[15]

(vi) If some of the state level taxes (which are many) are converted into state VAT the complexity of taxation will also be minimised. And at the end, it is possible to merge some of the centre's indirect taxes with it, i.e., arrival of the ***single VAT***.

Keeping all such things in mind, India started tax reform (Chelliah Committee and Kelkar Committee) and a certain level of sucess has been achieved in this area which can boost our motivation.

In the year 1996, the central government started collecting its excise duty on the VAT method and the tax was given a new name—the CENVAT.

The next proposal was to merge the states excise duty (imposed on intoxicants only) and their sales taxes into one tax—the state VAT or VAT. This could not take place due to states' lack of political will. Ultimately only sales taxes of the states were changed to be named VAT and was started to be collected on the basis of the VAT method (some states did not join it and some joined later). The experience has been encouraging.

Implementation Experience of VAT

The implementation experience of VAT in India has been very encouraging—the new tax system has been received well by all the stakeholders, the transition being quite smooth.[16] The revenue performance of VAT—implementing states/UTs (25) has been encouraging the tax revenue registered, an increase of 13.8 per cent over the annual growth rate of the last five years.[17] Only 8 states claimed for VAT compensation from the Centre in 2005–06 which came down to only 5 in the fiscal 2006–07.

GOODS AND SERVICES TAX

The Goods and Services Tax (GST) is a proposal[18] of tax in India which will emerge after merging many of the state and central level indirect taxes. Important points of the proposed GST are as follows:

(i) It will be a tax collected on the VAT method—having all the benefits of a VAT kind of tax.

(ii) It will be imposed all over the country with the uniformity of rate and will replace multiple central and state taxes (a *single VAT* it will be known). The taxes to be withdrawn or merged into the GST are—

Central Taxes: CENVAT, service tax, sales tax and stamp duty.

State Taxes: State excise, sales tax, entry tax, lease tax, works contract tax, luxury tax, octroi, turnover tax and cess.

(iii) The proposed tax has a single rate of 20 per cent of which centre and state will have a share of 12 per cent and 8 per cent, respectively.

The Union Budget 2006–07 repeated its commitment towards inplementation of GST. The major challenges in the path of its implementation as per the experts are as follows:

(i) States are collecting VAT with five rates—0 per cent, 1 per cent, 4 per cent and 20 per cent. The fifth rate is 12.5 per cent known as the RNR (revenue neutral rate). Now the challenge is to convince the states to be satisfied with their share of only 8 per cent in the GST at one hand and making it politically happen from the consumers point of view.

(ii) The next challenge is to decide the things like how and where to integrate central taxes and the state taxes as VAT or as the GST.

(iii) What to do with the custom duty is also a matter of concern as there is a move to integrate it with the GST at present.

The Government has announced (***Union Budget, 2013–14***) to implement the GST from the next fiscal year, i.e., 2012–13.

Recent Attempts to Implement GST

To operationalise the GST, the Constitution (115th Amendment) Bill [19] has been introduced in the Lok Sabha in March 2011 to enable the Parliament and state legislatures to make laws for levying GST on every transaction of supply of goods or services or both. Some goods, namely crude petroleum, diesel, petrol, aviation turbine fuel, natural gas and alcohol are not to come under the purview of the GST.

The constitutional amendment bill also seeks to empower the President to set up within 60 days of the passage of the legislation, a GST Council with the union Finance Minister as chairperson and union Minister of State for Revenue and Finance Ministers of all the states as members. The GST Council is to work on the basis of consensus and make recommendations on issues like GST rates, exemption lists, and threshold limits.

Further, the bill provides for setting up of a GST dispute settlement authority, comprising a chairperson and two members to resolve disputes arising out of deviations from the recommendations of the GST Council either by the central or state governments. The draft Bill has since been referred to the Parliamentary Committee on Finance for examination.

Among the other steps that are being taken for the introduction of the GST is the establishment of a strong information technology (IT) infrastructure. For this purpose the government has set up an ***Empowered Group*** headed by Nandan Nilekani, Chairman, Unique Identification Authority of India (UIDAI).

Significant progress has been made in the conceptualisation and design of the GST Network (GSTN), which is a common portal for the centre and states that will enable electronic processing of the key business processes of registration, returns and payments. For this purpose, the structure of these processes is in advanced stages of finalisation. The National Securities Depository Limited (NSDL) has been selected as technology partner for incubating the National Information Utility that will establish and operate the IT backbone for the GST. In this regard the NSDL has set up a pilot project in collaboration with eleven states prior to its roll-out across the country.

ADDITIONAL EXCISE DUTY

There is a tax in India known as the Additional Excise Duty (AED) imposed and collected by the centre. Basically, this is not a form of excise duty. At the same time, though the centre collects it the total corpus of collected tax is handed over to the states.

On the request of states, the central government passed the Goods of Special Importance Act, 1957 which empowered the centre to collect the AED on tobacco, textile and sugar in lieu of states' sales tax on them so that these regionally produced goods (which are consumed nationally) have uniform and affordable prices across the country.

Once VAT is fully operational in the economy this responsibility will be handed over to the states (as proposed) to be integrated with their VAT with the condition that none of these commodities will be charged VAT exceeding 4 per cent.

CST REFORMS

The Central Sale Tax (CST), being an origin—based non-rebatable tax, it is generally agreed, is inconsistent with the concept of VAT. That is why it needs to be phased out; the CST reforms is a part of the tax reforms in India. The critical issue involved in phasing out of CST is that of compensating the states for revenue losses on account of such a phase out. Since phasing out of CST will entail a revenue loss, states have been insisting on a mechanism to compensate them on a permanent basis. The 4 per cent rate of the CST has to be phased out in stages with 1 per cent phase out in one financial year and the states duly compensated through tax devolution. Because of phasing out, it is now at 2 per cent.

SERVICE TAX

The share of the services sector in the GDP of India has been going upward for the last decade. The introduction of service tax in 1994–95 by the Government of India has started paying the government

on its tax revenue front. Introduced to redress the asymmentric and distortionary treatment of goods and services in the tax regime, the service tax has seen gradual expansion in the country. The tax was introduced with only three services liable for taxation, gradually extended to over 100 services by 2007–08. The rate of tax has been risen to 12 per cent by the **Union Budget 2012-13** which becomes 12.33 per cent on account of the education cess.

In 2011-12, growth in service tax revenue was 37.4 per cent amounting to Rs. 97,579 crore, which indicated that service tax has been emerging as an important source of revenue (Union Budget 2012-13 had a growth target of 30.5 per cent in the revenue from service tax over 2011-12).[20] As *against the usual practice* of expanding the list of services, the Budget for 2012-13 introduced a ***'negative list'*** approach effective July 1, 2012. Service of *transportation of passengers* with or without accompanied belongings by railways in *first class* or *an air conditioned* coach and services by way of transportation of goods by railways has been subjected to service tax effective October 1, 2012.

VOLUNTARY COMPLIANCE ENCOURAGEMENT SCHEME

Announced in the *Union Budget 2013-14*, the Service Tax *Voluntary Compliance Encouragement Scheme (VCES)* is a one-time amnesty for those who have collected service tax but not deposited the same with the government. Those service tax providers that have not filed service tax return since October 2007 can disclose true liability and get an interest or penalty waive off.

COMMODITIES TRANSACTION TAX (CTT)

The *Union Budget 2013-14* has introduced (basically, *reintroduced*) the CTT, however, only for ***non-agricultural*** commodity futures at the rate of **0.01** per cent (which is equivalent to the rate of equity futures on which a *Securities Transaction Tax* is imposed in India). Alongwith this, transactions in commodity derivatives have been declared to be made *non-speculative*; and hence for traders in the commodity derivative segment, any losses arising from such transactions can be set off against income from any other source (similar provisions are also applicable for the securities market transactions).

Like all financial transaction taxes, CTT ***aims*** at discouraging excessive speculation, which is detrimental to the market and to bring parity between securities market and commodities market such that there is no tax/regulatory arbitrage. *Futures contracts* are financial instruments and provide for price risk management and price discovery of the underlying asset commodity / currency / stocks / interest. It is, therefore, essential that the policy framework governing them is uniform across all the contracts irrespective of the underlying assets to minimize the chances of regulatory arbitrage. The proposal of CTT also appears to have stemmed from the general policy of the government to widen the tax base.

Commodities Transaction Tax (CTT) is a tax similar to Securities Transaction Tax (STT), proposed to be levied in India, on transactions done on the domestic commodity derivatives exchanges. Globally, commodity derivatives are also considered as financial contracts. Hence CTT can also be

considered as a type of 'financial transaction tax'.

The concept of CTT was ***first*** introduced in the Union Budget 2008-09. The government had then proposed to impose a commodities transaction tax (CTT) of 0.017% (equivalent to the rate of equity futures at that point of time). However, it was withdrawn subsequently as the market was *nascent* then and any imposition of transaction tax might have adversely affected the growth of organised commodities derivatives markets in India. This has helped Indian commodity exchanges to grow to global standards [MCX is the world's ***No. 3*** commodity exchange; globally, MCX is ***No. 1*** in gold and silver, ***No. 2*** in natural gas and ***No. 3*** in crude oil].

SECURITIES TRANSACTION TAX (STT)

The STT is a type of 'financial transaction tax' levied in India on transactions done on the domestic stock exchanges. The rates of STT are prescribed by the Central government through its Budget from time to time. In tax parlance, this is categorised as a ***direct tax***. The tax came into effect from *October 1, 2004*. In India, STT is collected for the Government of India by the stock exchanges. With charging of STT, long-term capital gains tax was made ***zero*** and short-term capital gains tax was reduced to 10 per cent (subsequently, changed to 15 per cent since 2008).

The STT framework was subsequently reviewed by the central government in the year 2005, 2006, 2008, 2012 and ***2013***. The STT rates were revised upwards in the year 2005 and 2006 while it was reduced for certain segments in 2012 and 2013. The STT provisions were altered in the year 2008 such that for professional traders (brokers), STT came to be treated as an *expense* which can be deducted from the income instead of treating the same as an advance tax paid. [The 2004 STT provisions provided that the STT payments of professional traders, whose 'business income' arising from purchase and sale of securities could be set off against their total tax liability.]

As on date, STT is not applicable in case of *preference shares, Government securities, bonds, debentures, currency derivatives, units of mutual fund other than equity oriented mutual fund,* and *gold exchange traded funds* and in **such cases**, tax treatment of short-term and long-term gains shall be as per normal provisions of law.

Transactions of the shares of listed companies on the floor of the stock exchange or otherwise, mandated under the regulatory framework of SEBI, such as *takeover, buyback, delisting offers,* etc. also does not come under STT framework. The *off-market* transactions of securities (which entails changes in ownership records at depositories) also does not attract STT.

CAPITAL GAINS TAX

This is a direct tax and applies on the sales of all 'assets' if a profit (gain) has been made by the owner of the asset – a tax on the 'gains' one gets by selling assets. The tax has been classified into two –

(i) *Short Term Capital Gain* (STCG): It applies 'if the Asset has been sold within 36 months of owning it'. In this case the 'rate' of this tax is similar to the normal income tax slab. But the

period becomes' 12 months' in cases of shares, mutual funds, units of the UTI and 'zero coupon bond' – in this case the 'rate' of this tax is **15** per cent.

(ii) *Long Term Capital Gain* (LTCG): It applies 'if the asset has been sold after 36 months of owning it'. In this case the 'rate' of this tax is **20** per cent. In cases of shares, mutual funds, units of the UTI and 'zero coupon bond' there is 'exemption' (zero tax) from this tax (provided that such transaction is subject to 'Securities Transaction Tax').

INVESTMENT ALLOWANCE

Announced in the *Union Budget 2013-14*, a tax break given to companies for high value investment in plant and machineries, over and above depreciation benefits enjoyed by them. A company investing Rs. 100 crore or more in plant and machinery during the April 2013 to March 2015 will be entitled to deduct an investment allowance of **15** per cent of the investment. This is expected to see enormous spill-over benefits to small and medium enterprises.

The proposed investment allowance scheme should be seen a drain on the government's tax collections – it may be seen as a kind of *tax exemption*.

COLLECTION RATES

Given the large number of exemptions to rate of customs, the increase in value of imports does not necessarily imply similar magnitude in customs revenue. Collection rates are an indicator of overall incidence of customs tariffs including countervailing and special additional duties of imports. These are computed as the ratio of revenue collected from these duties to the aggregate value of imports in a year (or period) and thus represent trade-weighted tariffs. The trends in the rates for important commodity groups as well as for all commodities taken together over the years are shown in Table 3.5. A major reason for the fall in rates has been the lower levels of duties on many items including on petroleum, oil, and lubricants (POL), which has significant import value and of course the impact of the various exemptions. At overall level, the effective rate of taxes at around 6 per cent in 2011-12 as against the level of simple average tariff rates of basic customs duties and the CVD indicates the impact of exemptions.[21]

TAX EXPENDITURE

As per the current *Economic Survey 2012-13*, there is significant divergence in India between the official rates of taxes and the actual or *effective rate of taxation* (which is a simple 'ratio of tax revenue collected to the tax base'). This arises on account of the *exemptions* to the tax rate. As indicated earlier in the section on *collection rates*, the magnitude of **revenue foregone** *(*i.e. *tax expenditure)* is indeed high.

In case of the ***direct taxes***, the situation prevails as given below:

- Tax foregone on account of exemptions under *corporate income tax* for 2011-12 was estimated at Rs. 51,292 crore. In this case, ***deduction*** on account of accelerated depreciation, deduction for export profits of export-oriented units located in special economic zones (SEZs) and profits of businesses in the power and telecom sectors were some of the major incentives. Though, the absolute amount of deductions has decreased as a result of phasing out of profit-linked deductions.
- Tax forgone on account of exemptions under *personal income tax* for individual taxpayers was estimated at Rs. 35,698 crore in 2011-12. In this case, the bulk of the revenue foregone was on account of the exemptions given for certain investments and payments under Section 80 C of the Income Tax Act.

In so far as ***indirect taxes*** are concerned, revenue forgone is defined as the difference between duty that would have been payable but for the issue of exemption notification and actual duty paid in terms of the relevant notification. The situation stands as given below:

- The revenue forgone for the financial year 2011-12 in respect of *excise duties* is estimated at Rs. 2,12,167 crore including Rs. 12,880 crore on account of area-based exemptions.
- Duty forgone for the year 2011-12 on account of all the exemption notifications on *customs* was estimated at Rs. 2,76,093 crore.

There is merit in limiting the exemptions or their *grandfathering* [22] on a case-by-case basis so as to realize fuller tax potential through a wider tax base. The *Direct Tax Code 2010* has enough scope to cut such exemptions. Similarly, the on-going indirect tax reforms such as the GST has such provisions.

14TH FINANCE COMMISSION

The Commission was constituted on *January 2, 2013* under the Chairmanship of Dr. Y. V. Reddy, former RBI Governor with Prof. Abhijit Sen, Ms. Sushma Nath, Dr. M. Govinda Rao and Dr. Sudipto Mundle as the other *four* members. The recommendations of the Commission will apply on the period ***2015-20*** and its report has to be submitted by October 31, 2014.

The broad *Terms of Reference* and the *matters* to be taken into consideration by the Commission are:

1. *Tax Devolution & Grant* related references
   (i) the distribution between the union and states of the net *proceeds of taxes* which are to be, or may be, divided between them under *Chapter I, Part XII* of the Constitution and the allocation between the states of the respective shares of such proceeds;
   (ii) the principles which should govern the *grants-in-aid* of the revenues of the states out of the Consolidated Fund of India and the sums to be paid to the states which are in need of assistance by way of grants-in-aid of their revenues under *Article 275* of the Constitution for purposes other than those specified in the provisos to *Clause (1)* of that article; and
   (iii) measures needed to augment the Consolidated Fund of a state to supplement the resources of the *panchayats* and *municipalities* in the state on the basis of the recommendations made by the Finance Commission of the state.

2. To review the state of finances, *deficit*, and *debt* levels of the union and states and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the FRBMAs currently in force. The Commission has been asked to consider and recommend incentives and disincentives for states for observing the obligations laid down in the FRBMAs.
3. In Commission is required to consider –
   - the *resources* of the central government and the *demands* on the resources of the central government;
   - the *resources* of the state governments and *demands* on such resources under different heads, including the impact of debt levels on resource availability in debt-stressed states;
   - the objective of not only balancing the receipts and expenditure on revenue account of all the states and the union but also generating surpluses for capital investment;
   - the *taxation efforts* of the central government and each state government and the potential for additional resource mobilization;
   - the level of *subsidies* required for sustainable and inclusive growth and equitable sharing of subsidies between the central and state governments;
   - the *expenditure* on the non-salary component of maintenance and upkeep of capital assets and the non-wage-related maintenance expenditure on Plan schemes to be completed by March 31, 2015 and the norms on the basis of which specific amounts are recommended for the maintenance of capital assets and the manner of monitoring such expenditure;
   - the need for *insulating the pricing* of public utility services like drinking water, irrigation, power, and public transport from policy fluctuations through statutory provisions;
   - the need for making public-sector enterprises competitive and market oriented; listing and disinvestment; relinquishing of non-priority enterprises;
   - the need to balance *management of ecology, environment, and climate change* consistent with sustainable economic development; and
   - the impact of the proposed *goods and services tax* on the finances of the centre and states and the mechanism for compensation in case of any revenue loss.
5. To review the present *public expenditure management* systems and recommend, including –
   - budgeting and accounting standards and practices;
   - the existing system of classification of receipts and expenditure;
   - linking outlays to outputs and outcomes; and
   - best practices within the country and internationally.
6. To review the present arrangements of financing of *Disaster Management* with reference to the funds constituted under the Disaster Management Act 2005 and make recommendations.
7. To indicate the basis on which it has arrived at its findings and make available the *state-wise estimates of receipts and expenditure*.

The Commission is required to generally take the base of population figures as of 1971 in all cases

where population is a factor for determination of devolution of taxes and duties and grants-in-aid. However, the Commission may also take into account the demographic changes that have taken place subsequent to 1971.

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1. Samuelson and Nordhaus, ***Economics,*** op. cit., p. 327.
2. For further references, Stiglitz and Walsh, ***Ecnomics,*** op. cit., pp. 378–79 may be referred.
3. Samuelson and Nordhaus, ***Economics,*** op. cit., pp. 75–77.
4. Ibid., pp. 75–77.
5. Samuelson and Nordhaus, ***Economics,*** op. cit., p. 329.
6. Ibid., p. 329.
7. Samuelson and Nordhaus ***Economics,*** op. cit., p. 329; Stiglitz and Walsh, ***Economics,*** op. cit., p. 380.
8. Ibid.
9. Samuelson and Nordhaus, ***Economics,*** op. cit., p. 329.
10. Stiglitz and Walsh, ***Economics,*** op. cit., 382. A comprehensive analysis of good tax structure is also given in ***Meade Committe Report,*** Institute for Fiscal Studies (IFS), Washington DC, 1978.
11. Based on the discussion on Government Expenditure in Samuelson and Nordhaus, ***Economics,*** op. cit.
12. Ibid., p. 333
13. Derived from the points forwarded by the ***GoI*** and the ***Empowered Group of State Ministers.***
14. Raja C. Chelliah, Pawan K. Aggarwal, Mahesh C. Purohit and R. Kavita Rao, ***Introduction to Value Added Tax*** , in Amaresh Bagchi edited ***Readings in Public Finance,*** Oxford University Press, N. Delhi, 2005, pp. 277–78.
15. Ibid.
16. *Economic Survey 2006–07,* MoF, GoI, N. Delhi, pp. 46–47.
17. Ibid.
18. Recommended by the Vijay Kelkar *Task Force on FRBM, 2003,* GoI, N. Delhi.
19. ***Economic Survey 2011-12,*** op. cit., p. 57
20. **Economic Survey 2012-13**, op. cit.
21. **Economic Survey 2012-13**, op. cit.
22. **Grandfather Clause** – a clause in a new law that exempts certain persons or businesses from abiding by it. For example, suppose a country passes a law stating that it is illegal to own a cat. A grandfather clause would allow persons who already own cats to continue to keep them, but would prevent people who do not own cats from buying them. Grandfather clauses are controversial, but they are common around the world. [*Source:* **Farlex Financial Dictionary**, Farlex Inc., N. York, USA, 2012; **Collins English Dictionary- Complete & Unabridged**, HaperCollins, N. York, USA, 2003.]

18

PUBLIC FINANCE IN INDIA

*How the modern governments do manage all money they get – the public money – is the subject matter of public finance. The policy stance taken in this regard is declared annually by the governments via their 'fiscal policy' popularly known as the Budget.**

- Introduction
- Budget
- Deficit Financing
- Fiscal Policy
- Indian Fiscal Situation: A Summary
- Limiting Government Expenditure
- Fiscal Consolidation in India
- Zero-Base Budgeting
- Results-Framework Document (RFD)
- Charged Expenditure
- Types of Budgets
- Cut Motion
- Trilemmas
- Treasury Computerisation of State
- CRIS of India
- The Economy Today: 2013-14
- Special Category States

* See Amaresh Bagchi edited, *Readings in Public Finance*, Oxford University Press, N. Delhi, 2005. Also see Paul A. Samuelson and William D. Nordhaus, *Economics*, The McGraw-Hill Company, New York, USA, 2005, pp. 412, 711. Also see Joseph E. Stiglitz and Carl E. Walsh, *Economics*, W. W. Norton, New Yok, USA, 4th Edition, 2006, p. 695-697.

INTRODUCTION

Public finance is a much wider title which includes all those matters which are connected with public money, the money a government gets, spends, borrows, lends, raises or prints. Public finance, i.e., finances of the government now named as *public economics* does not only discuss the issue that how much of the country's resources the government should acquire for its own use but also discusses the 'efficiency' with which the money should be used. Public finance gets reference in the ancient treatise ***Arthashastra***[1] of Kautilya which covers 'treasury, sources of revenue, accounts and audit' in a very detailed way—however, the subject has gathered much significance in the post Second World War period once the governments' role in the economy started expanding[2] due to various reasons namely, the rise of public sector, delivery of public goods, law and order, defence, etc. By the Second World War, the importance of the government's role in the economy was emergently felt and it was believed that all needs of the people cannot be met if the economy is left to the market (i.e., private sector) in its entireity. For example, national defence, law enforcement and other major areas which must be cared for by the national government besides the supplies of ***affordable or free*** healthcare, education, social security measures, etc. could only be taken care of by the governments (***as they are not profit driven)***. This is why there was an agreement among the experts and the policymakers to expand the government's role in the economy. This led to the ultimate rise of the public sector around the world.[3] Here we will be looking into the major concepts related to the area of public finance with special reference to India.

BUDGET

An annual financial statement of income and expenditure is generally used for a government, but it could be of a firm, company, corporation etc[4]. The 'word' has its origin in the British parliamentary exercise of preparing such statement way back in the mid-18th century from the French word *'Bugeut'* meaning a leather bag out of which the financial statement was brought out and presented in the parliament. Today, this word is used to mean the annual statement in all economies around the world.

The Constitution of India has a provision (Art. 112) for such a document called Annual Financial Statement to be presented in the Parliament before the coummencement of every new fiscal year—popular as the Union Budget. Same provision is there for the States too.

Data in the Budget

The Union Budget has ***three sets***[5] of data for every concerned sector or sub-sector of the economy:

(i) Actual data of the preceding year (here preceding year means one year before the year in which the Budget is being presented. Suppose the Budget presented is for the year 2008–09, the Budget will give the final/actual data for the year 2006–07 because the Budget is presented in February end of financial year 2007–08. After the data either we write '**A**', means actual data/final data or write nothing (India writes nothing).

(ii) Provisional data of the current year (since the Budget for 2008–09 is presented at the end of the fiscal 2007–08, it provides Provisional Estimates for this year (shown as ‘**PE**’ in brackets with the data).

(iii) Budgetary estimates for the following year (here following year means one year after the year in which the Budget is being presented or the year for which the Budget is being presented, i.e., 2008–09. This is shown with the symbol ‘**BE**’ in brackets with the concerned data.).

One comes across certain other kinds of data, too in day-to-day government economic literature. There are such three other kinds of data—

(i) Revised Estimate (RE)

Revised Estimate is basically a current estimation of either the budgetary estimates (BE) or the provisional estimates (PE). It shows the contemporary situation. It is an interim data.

(ii) Quick Estimate (QE)

Quick Estimate is a kind of revised estimate which shows the most latest situation and is useful in the process of going for future projections for some sector or sub-sector. It is an interim data.

(iii) Advance Estimate (AE)

Advance Estimate is a kind of quick estimate but done ahead (is advance) of the final stage when data should have been collected. It is an interim data.

Developmental and Non-developmental Expenditure

Total expenditure incurred by the government is classified into two segments—developmental and non-developmental. All expenditures of productive nature are developmental such as on the heads of new factories, dams, bridges, roads, railways, etc.—all *investments.*

The expenditures which are of consumptive kind and do not involve any production are non-developmental, i.e., paying salaries, pensions, interest payments, subsidies, defence expenses, etc.

This classification is not used in the Indian Public finance management now (see *Plan* and *Non-Plan Expenditure,* in the next entry).[6]

Plan and Non-Plan Expenditure

Every expenditure incurred on the public exchequer is classified into two categories—the plan and the non-plan. All those expenditures which are done in India in the name of *planning* is the *plan expenditure* and rest of all are *non-plan expenditures*. Basically, all asset creating, and productive expenditures are plan and all consumptive, non-productive, non-asset building are non-plan expenditures and are developmental and non-developmental expenditures, respectively.

Since the financial year 1987–88, there was a terminology change in Indian public finance literature when developmental and non-developmental expenditures were replaced by the new terms plan and non-plan expenditures, respectively. (It was suggested by the Sukhomoy Chakravarti committee.)[7]

Meanwhile, a high-power Panel headed by Dr. C. Rangarajan (Chairman, Prime Minister's Economic Advisory Council), in *September 2011* suggested for redefining ***Plan*** and ***Non Plan*** expenditures as the ***Capital*** and ***Revenue*** expenditures as the former set of terms 'blur the classification' – this will facilitate linking expenditure to 'outcomes' and better public expenditure, the panels suggested. *Major* suggestions of the Panel are:

- *Plan* and *Non-Plan* distinction in the Budget is neither able to provide a satisfactory classification of 'developmental' and 'non-developmental' dimensions of government expenditure nor an appropriate budgetary framework. It has therefore become 'dysfunctional',
- Suggests for *redefining roles* of the Planning Commission (PC) and the Finance Ministry (FM) as per which the PC should be responsible for formulation of the five-year plan and the task of firming up annual budgets should be entrusted to the FM.
- The PC should dispense with the exercise of approving annual plans of states and it could hold a strategy or review meeting with representatives of the states.
- Public expenditures should be split into *capital* and *revenue* expenditures.
- Public expenditure should have 'management approach' based on measurable 'outcomes', indicating that the reponsibility should be assigned to the Finance Ministry.

Analysis of the Situation: While the need for looking beyond the budget is well accepted, there are many factors raising doubts on the 'efficacy' and 'relevance' of the five-year plans as the instrument. The division of expenditure between *Plan* and *non-Plan* is artificial and creates problems, such as –

- Plan expenditure tends to get priority especially when austerity and expenditure reduction has to be done periodically for fiscal consolidation. Non-Plan expenditure gets the ***cut*** even if it is vitally needed for economic development, an example is budget provision for maintenance of assets such as hospitals, schools and irrigation dams already created under Plan but whose maintenance is treated as non-Plan.
- Review and implementation of schemes is another area of direct responsibility for the Ministry of Finance and the Ministry of Statistics and Programme Implementation. The Finance Minister himself had, in the budget speech for 2005-06, promised to ensure that programmes and schemes were not allowed to continue indefinitely from one Plan period to another without an independent and in-depth evaluation. The Planning Commission, serving as the *focal point for Plan allocations*, dilutes the role of the Finance Ministry in this case.
- 'Output' and 'Outcome Budgeting' was introduced by the Central Government from the Budget for 2005-06. Non-Plan expenditure remains out of its purview. This means, for example, the outcome of expenditure on running schools and hospitals will not be evaluated. This again is another fallout of the artificial division into Plan and non-Plan.

The ***dichotomy*** results in *dual* and *confusing* responsibility of the Ministry of Finance and the Planning Commission and adversely affects the whole budget process, formulation and implementation. The Ministry of Finance is responsible for fiscal consolidation, containing the fiscal deficit and abiding to the FRBM Act. But in formulating the Budget its role in Plan expenditure budgeting is *diluted* by the discussions which the ministries have with the Planning Commission. The finalisation of Plan allocations for the State budgets also suffers from this weakness. Ultimately, the Central Government has to fix the market borrowing by State governments taking the overall

sustainable borrowing limits, including the requirements of the Central Government. The Planning Commission tends to have a more optimistic estimate of resources likely to be available for financing the Plan expenditure as 'fiscal deficit' management and control is not its direct responsibility.

Revenue

Every form of money generation in the nature of income, earnings are revenue for a firm or a government which do not increase financial liabilities of the government—i.e., the tax incomes, non-tax incomes along with foreign grants.

Non-revenue

Every form of money generation which is not income or earnings for a firm or a government (i.e., money raised via borrowings) is considered a non-revenue source if they increase financial liablities.

Receipts

Every receiving or accrual of money to a government by revenue and non-revenue sources is a receipt. Their sum is called *total receipts*. It includes all incomes as well as non-income accruals of a government.

Revenue Receipts

Revenue receipts of a government are of two kinds—Tax Revenue Receipts and Non-tax Revenue Receipts—consisting of the following income receipts in India:

Tax Revenue Receipts

This includes all money earned by the government via the different taxes the government collects, i.e., all direct and indirect tax collections.

Non-tax Revenue Receipts

This includes all money earned by the government from sources other taxes. In India they are—

(i) *Profits* and *dividends* which the government gets from its public sector undertakings (PSUs).

(ii) *Interests* recieved by the government out of all loans forwarded by it, be it inside the country (i.e., internal lending) or outside the country (i.e., external lending). It means this income might be in both domestic and foreign currencies.

(iii) *Fiscal services* also generate incomes for the government, i.e., currency printing, stamp printing, coinage and medals minting, etc.

(iv) *General Services* also earn money for the government as the power distribution, irrigation, banking, insurance, community services, etc.

(v) *Fees*, *Penalties* and *Fines* received by the government.

(vi) *Grants* which the governments receives—it is always external in the case of the central

government and internal in the case of state governments.

Revenue Expenditure

All the expenditures incurred by the government are either of *revenue kind* or *current kind* or *compulsive kind.* The basic identity of such expenditures is that they are of consumptive kind and do not involve creation of productive assets. They are either used in running of a productive process or running a government. A broad category of things that fall under such expenditures in India—

(i) *Interest* payment by the government on the internal and external loans;

(ii) *Salaries, Pension* and *Provident Fund* paid by the government to the government employees;

(iii) *Subsidies* forwarded to all sectors by the government;

(iv) *Defence* expenditures by the government;

(v) *Postal Deficits* of the government;

(vi) *Law and order* expenditures (i.e., police & paramilitary);

(vii) Expenditures *on social services* (includes all social sector expenditures as education, health care, social security, poverty alleviation, etc.) and *general services* (tax collection, etc.);

(viii) *Grants* given by the government to Indian states and foreign countries.

Revenue Deficit

If the balance of total revenue receipts and total revenue expenditures turns out to be negative it is known as revenue deficit, a new fiscal terminology used since the fiscal 1997–98 in India.[8]

This shows that the government's *Revenue Budget* (see the next topic) is running in losses and the government is earning less revenue and spending more revenues—incurring a deficit. Revenue expenditures are of immediate nature (this has to be done) and since they are consumptive/non-productive they are considered as a kind of expenditure which sums up to a heinous crime in the area of fiscal policy. Governments fulfill the gap/deficit with the money which could have been spent/intvested in productive areas.

A government might have its revenue expenditures less than its revenue receipts, i.e., having (*revenue surplus*) budget. Such fiscal policy is considered good where the government has been able to manage some money out of its revenue budget which could be spent for the creation of productive assets. Yes, another thing that should be kept in mind, as how the government has managed this surplus and whether the policies which made this happen are judicious enough or not. In the Second Plan, India emerged as a revenue-suplus state but experts did not appreciate it as it had many bad impacts on the economy—higher tax rates culminated in tax evasion, corruption, creation of black money, etc.

Revenue deficit may be shown in the quantitative form (as how much the gross/total deficit is in currency terms) or in percentage terms of the GDP for that particular year (shown as percentage of GDP). Usually, it is shown in percentage of the GDP for domestic as well as international analyses.

Effective Revenue Deficit

Effective revenue deficit (ERD) is a new term introduced in the *Union Budget 2011-12*. Conventionally, 'revenue deficit' is the difference between revenue receipts and revenue expenditures. Here, revenue expenditures includes all the grants which the Union Government gives to the state governments and the UTs – some of which ***create assets*** (though these assets are not owned by the GoI but the concerned state governments and the UTs). According to the Finance Ministry (Union Budget 2011-12), such revenue expenditures contribute to the growth in the economy and therefore, *should not be treated as unproductive* in nature like other items in the revenue expenditures. And on this logic, a new methodology was introduced to capture the 'effective revenue deficit', which is the Revenue Deficit 'excluding' those revenue expenditures of the GoI which were done in the form of **GoCA** (grants for creation of capital assets).

The GoCA includes the GoI grants forwarded to the States & UTs for the implementation of the centrally sponsored programmes such as Pradhan Mantri Gram Sadak Yojana, Accelerated Irrigation Benefit Programme, Jawaharlal Nehru National Urban Renewal Mission, etc. – these expenses though they are shown by the GoI in its Revenue Expenditures they are involved with *asset creation* and cannot be considered completely 'unproductive' like other items put in the basket of the Revenue Expenditures – the reason why a new 'terminology' has been created.

As per the ***Union Budget 2013-14***, by the fiscal 2016-17, the Revenue Deficit to be 1.5 per cent and the 'effective revenue deficit' to **zero** per cent [it means that by that year the total GoCA forwarded by the GoI will stand at 1.5 per cent of the GDP of the year].

Revenue Budget

The part of the Budget which deals with the income and expenditure of revenue by the government.

This presents the annual financial statement of the total revenue receipts and the total revenue expenditure—if the balance emerges to be positive it is a revenue surplus budget, and if it comes out to be negative, it is a revenue deficit budget.

Capital Budget

The part of the Budget which deals with the receipts and expenditures of the capital by the government. This shows the means by which the capital is managed and the areas where capital is spent.

Capital Receipts

All non-revenue reciepts of a government are known as the capital receipts. Such receipts are for investment purposes and supposed to be spent on plan-development by a government. But the receipts might need their diversion to meet other needs to take care of the rising revenue expenditure of a government as the case had been with India. The capital receipts in India include the following capital kind of accruals to the government—

(i) Loan Recovery

This is one source of the capital receipts. The money the government had lent out in past in India

(states, UTs, PSUs, etc.) and abroad their capital comes back to the government when the borrowers repay them as capital receipts. The interests which come to the government on such loans are part of the revenue receipts.

(ii) Borrowings by the Government

This includes all long-term loans raised by the government inside the country (i.e., internal borrowings) and outside the country (i.e., external borrowings). Internal borrowings might include the borrowings from the RBI, Indian banks, financial institutions, etc. Similarly, external borrowings might include the loans from the World Bank, the IMF, foreign banks, foreign governments, foreign financial institutions, etc.

(iii) Other Receipts by the Governments

This includes many long-term capital accruals to the government through the Provident Fund (PF), Postal Deposits, various small saving schemes (SSSs) and the government bonds sold to the public (as Indira Vikas Patra, Kisan Vikas Patra, Market Stabilisation Bond, etc.). Such receipts are nothing but a kind of loan on which the government needs to pay interests on their maturities. But they play a role in capital raising process by the government.

Capital Expenditure

All the areas which get capital from the government are part of the capital expenditure. It includes so many heads in India —

(i) Loan Disbursals by the Government

The loans forwarded by the government might be internal (i.e., to the states, UTs, PSUs, FIs, etc.) or external (i.e., to foreign countries, foreign banks, purchase of foreign Bonds, loans to IMF and WB, etc.).

(ii) Loan Repayments by the Government of the Borrowings Made in the Past

Again loan payments might be internal as well as external. This consists of only the *capital* part of the loan repayment as the element of interest on loans are shown as a part of the *revenue expenditure.*

(iii) Plan Expenditure of the Government

This consists of all the expenditures incurred by the government to finance the planned development of India as well as the central government financial supports to the states for their plan requirements.

(iv) Capital Expenditures on Defence by the Government

This consists of all kinds of *capital* expenses to maintain the defence forces, the equipment purchased for them as well as the modernisation expenditures. It should be kept in mind that *defence* is a non-

plan expenditure which has capital as well as revenue expenditures element in its maintenance. The revenue part of expenditure in the defence is counted in the revenue expenditures by the government.

(v) General Services

These also need huge capital expenditure by the government—the railways, postal department, water supply, education, rural extension, etc.

(vi) Other Liabilities of the Government

Basically, this includes all the repayment liabilities of the government on the items of the Other Receipts. The level of liabilities depends on the fact as to how much such receipts were made by the governments in the past. How much payment liabilities in which year also depends on the fact as to which years in the past the governments had other receipts and for what duration of maturity periods. As for example, the *PF liabilities* were not an item of such liabilities for almost first three decades after the independence. But once the government employees started retiring, it went on increasing. Future India (specially 1960s and 1970s) saw expansion of the PSUs and excessive employment generation in them (devoid of the logic of labour requirement). We see the PF liabilities expanding like anything throughout the 1990s—the governments had been under pressure to manage this segment either by cutting interest on PF or at present trying to make it a matter of market economy. Same thing happened with the element of *pension* and we have been able to devise a market mechanism for it once pension reforms took place and the arrival of a pension regulatory authority for the area.

Capital Deficit

There is no such term in public finance or in economics as such. But in practice one usually hears the use of the term capital crunch, scarcity of capital in day-to-day economic news items. Basically, the government in the news is facing the problem of managing as much funds, money, capital as is required by it for public expenditure. Such expenditure might be of revenue kind or capital kind. Such difficulties have always been with the developing economies due to their high level requirement of capital expenditures. Had there been a term to show this situation, it would naturally have been *Capital Deficit*.

Fiscal Deficit

When balance of the government's total receipts (i.e., revenue + capital reeipts) and total expenditures (i.e., revenue + capital expenditures) turns out to be negative, it shows the situation of fiscal deficit, a concept being used since the fiscal 1997–98 in India.[9]

The situation of fiscal deficit indicates that the government is spending beyond its means. To be more simple, we may say that the government is spending more than its income (though in practice all receipts of the government are not income. Basically, receipts are all forms of money accruing to the government, be it income or borrowings!).

Fiscal deficit may be shown in the quantitative form (i.e., the total currency value of the deficit) or in the percentage form of the GDP for that particular year (percentage of GDP). In general, the

percentage form is used for domestic or international (i.e., comparative economics) studies and analyses.

India has been a country of not only regular but higher fiscal deficits. Moreover, the composition of its fiscal deficit has been more prone to criticism (we will see this in the forthcoming sub-title ahead).

Primary Deficit

The fiscal deficit excluding the interest liabilities for a year is the primary deficit, a term India started using since the fiscal 1997–98.[10] It shows the fiscal deficit for the year in which the economy had not to fulfill any interest payments on the different loans and liabilities which it is obliged to—shown both in quantitative and percentage of GDP forms.

This is considered a very handy tool in the process of bringing in more transparency in the government's expenditure pattern. Any two years for example might be compared and so many things can be found out clearly such as, which year the government depended more on loans, the reasons behind higher or lower fiscal deficits, whether the fiscal deficits have gone down due to falling interest liabilities or some other factors, etc.

Monetised Deficit

The part of the fiscal deficit which was provided by the RBI to the government in a particular year is Monetised Deficit, this is a new term adopted since 1997–98 in India.[11] This is shown in both the forms—in quantitative as well as a percentage of the GDP for that particular financial year.

It is an innovation in the fiscal management which brings in more transparency in the government's expenditure behaviour and also in its capabilities concerning its dependence on market borrowings by the RBI. Basically, every year both central and state governments in India had been depending heavily on market borrowings (internal) for its long-term capital requirements. Market borrowings of the government are done and managed by the RBI. Besides, the RBI is also the primary customer for government securities—yet another means of the government to raise long-term capital. This has been a major area of fiscal concern in India. After the process of **fiscal consolidation** was started by the government by the early 1990s, we see a visible improvement in this area. This term is itself arrived as the part of fiscal reforms in India (we will visit the issue of fiscal consolidation in India in the coming pages).

Deficit and Surplus Budget

When the budgetary proposals of a government for a particular year proposes higher expenditures than the receipts, it is known as a *deficit budget*. Opposite to this, if the budget proposes lesser expenditures than the receipts, then it is a *surplus budget.*[12]

In practice, governments the world over usually do not present a surplus budget as it symbolises government's lower concerns towards development. But at times as a political weapon a government might come out with such a budget (for example the Uttranchal Budget for 2006–07 was a surplus budget!). How can a government propose for a surplus budget in a developing state when even

developed countries still need development and are going for deficit budgets? The Union Budget in India had never been presented as a surplus budget.

DEFICIT FINANCING

The act/process of financing/supporting a deficit budget by a government is deficit financing. In this process, the government knows well in advance that its total expenditures are going to turn out to be more than its total receipts and enacts/follows such financial policies so that it can sustain the burden of the deficits proposed by it.

First used in the area of public finance in the early 1930s in USA,[13] today the term is being used by the corporate sector, too and such a financial management of a firm might be followed by it as part of its business strategy. Again, a sick firm might need to follow deficit financing route for many years to come as required by the firm to make it come out of the red (i.e., doing away with the losses).

Need of Deficit Financing: It was in late 1920s that the idea and need of deficit financing was felt. It is when government needs to spend more money than it was expected to earn or generate in a particular period, to go for a desired level of growth and development. Had there been some means to go for more expenditure with less income and receipts, socio-political goals could have been realised as per the aspirations of the public policy! And once the growth had taken place the extra money spent above the income would have been reimbursed or repaid! This was a good public/government wish which was fulfilled by the evolution of the idea of deficit financing.

It was by early 1930s that the US first tried its hand at deficit financing soon to be followed by the whole Euro-American governments.[14] Through this route the developed world was able to come out of the menace of the Great Depression (1929).[15] The idea became popular around the world by the 1960s. India tried its hand at deficit financing in 1969 and since the 1970s it became a routine phenomenon, till it became wild and illogical, demanding immediate redressal. The fiscal deficits in India did not only peak to unsustainable levels but its composition was also not justified and not based on sound fundamentals of economics. Finally, India headed for a slow but confident process of fiscal reforms that is also known as the process of fiscal consolidation (to be discussed in the coming pages).

Means of Deficit Financing: Once deficit financing became an established part of public finance around the world, the means of going for it were also evolved by that time. These means, basically are the ways in which the government may utilise the amount of money created as the deficit to sustain its budget for developmental or political needs. These means are given below in order of their suggested and tried preferences.

(i) *External Aids*[16] are the best money as a means to fulfill a government's deficit requirements even if it is coming with soft interest. If they are coming without interest nothing could be better.

When India went to borrow from the IMF in the wake of the financial crisis of 1990–91, the body advised India to keep its fiscal deficit to the tune of 4.5 per cent of its GDP and noted it to be sustainable for the economy. What was the rationale behind this data? Basically, in those times with the foreign aids (soft loans either from the *WB* or from the *Aid India Forum*) India was able to

manage its budget to the tune of 4.5 per cent of its GDP! In 2002, when India's fiscal deficit was around 6 per cent (5.7 per cent to be precise) the IMF validated it to be sustainable, the reasons were two—first, India was able to show a check on fiscal deficit and secondly, at the same time the forex reserves of the country were suitably higher to neutralise the negative impacts of the higher fiscal deficit than the suggested levels (4.5 per cent)!

External Grants are even better element in this case (which comes free—neither interest nor any repayments!) but it either did not come to India (since 1975, the year of the first Pokhran testings) or India did not accept it (as happened post-Tsunami, arguing grants/aids coming with a tag/conditions). That is why here this segment has not been discussed as a means to manage deficit.

(ii) *External Borrowings*[17] are the next best way to manage fiscal deficit with the condition that the external loans are omparatively cheaper and long-term.

Though external loans are considered an erosion in the nations sovereign decision making process, this has its own benefit and is considered better than the internal borrowings due to two reasons:

(a) External borrwing bring in foreign currency/hard currency which gives extra edge to the government spending as by this the government may fulfill its developmental requirements inside the country as well as from outside the country.

(b) It is prefered over the internal borrowings due to crowding out effect. If the government itself goes on borrowing from the banks of the country, from where will others borrow for investment purposes?

(iii) *Internal Borrowings*[18] comes as the third preferred route of fiscal deficit management. But going for it in a huge way hampers the investment prospects of the public and the corporate sector. It has the same impact on the expenditure pattern in the economy. Ultimately, economy heads for a double negative impact—lower investment (leading to lower production, lower GDPs and lower per capita income, etc.) and lower demands (by the general public as well as by the corporate world) in the economy—the economy moves either for *stagnation* or for a *slowdown* (one can see them happening in India repeatedly throughout the 1960s, 1970s, 1980s). The situation improved after the mid-1990s.

(iv) *Printing Currency* is the last resort for the government in managing its deficit.[19] But it has the biggest handicap that with it the government cannot go for the expenditures which are to be made in the foreign currency. Even if the government is satisfied on this front, printing fresh currencies does have other damaging effects on the economy:

(a) It increases inflation proportionally. (India regularly went for it since early 1970s and usually had to bear double digit inflations.)

(b) It brings in regular pressure and obligation on the government for upward revision in wages and salaries of government employees—ultimately increasing the government expenditures necessitating further printing of currency and further inflation—a vicious cycle into which economies entangle themselves.

Now, it remains a matter of choice and availability of the above-given means, and which means a government adopts and in what proportion, for fulfilling its deficit requirement.

Composition of Fiscal Deficit

The Keynesian idea of deficit financing, though he advocated it, had a catch in it also which was usually missed by third world economies or intentionally overlooked by them. The catch is related to the question as to why an economy wants to go for fiscal deficit. And thus it becomes essential to go for an analysis of the composition[20] of the fiscal deficit of a government.

Out of the two broad expenditure obligations of a government—revenue expenditure and capital expenditure—the following combinations of expenditure composition are suggested:

(i) A fiscal deficit with a surplus revenue budget or a zero revenue expenditure is the best composition of fiscal deficit and the most suitable time for deficit financing.

(ii) The deficit requirements for lower revenue expenditures and higher capital expenditures are the next best situation for deficit financing, provided revenue deficit is eliminated soon.

(iii) The last could be the situation when major part of deficit financing is to fulfill revenue expenditures and a minor part to go for capital expenditures. The total money of the deficit might go to fulfil revenue expenditure, which could be the worst form of it.

Basically, there should be a judicious mix of plan and non-plan expenditure as well as revenue and capital expenditures in India. Lesser non-plan expenditure or higher plan-expenditure are better reasons behind deficit financing in India (though India has a typical feature of capital expenditure which makes this combination of deficit financing not a suggested form—discussed ahead).

Third world economies (including India) though went for higher and higher fiscal deficits and deficit financing, they either did not address or failed to address the composition of deficit favourable towards capital and non-revenue expenditures.

FISCAL POLICY

The real meaning, significance and impact of fiscal policy emerged in the wake of the Great Depression and the Second World War. Fiscal policy has been **defined** as 'the policy of the government with regard to the level of government purchases, the level of transfers, and the tax structure'—probably the best and the most acclaimed definition among experts.[21] Later, the impact of fiscal policy on macro-economy was beautifully analysed.[22] As the policy has a deep impact on the overall performance, of the economy, fiscal policy is also **defined** as the policy which handles public expenditure and tax to direct and stimulate the level of economic activity (numerically denoted by the Gross Domestic Product).[23] It was J. M. Keynes, the ***first*** economist who developed a theory linking fiscal policy and economic performance.[24]

Fiscal policy is also **defined** as 'changes in government expenditures and taxes that are designed to achieve macroeconomic policy goals'[25] (such as growth, employment, investment, etc.). Therefore, we say that 'fiscal policy denotes the use of taxes and government expenditures'.[26]

How the taxes and the government expenditures influence the overall economy, has been explained in a brief discussion here.[27] Let us first discuss the ***taxes*** and their impact on the economy:

(i) Taxes have a direct bearing on people's income affecting their levels of disposable incomes, purchase of goods and services, consumption and ultimately their standard of living;

(ii) Taxes directly affect the savings of individuals, families and the firms which affect investment

in the economy—as investment affects the output (GDP) thereby influencing the per capita income;

(iii) Taxes affect the prices of goods and services as factor cost (production cost) is affected thereby affecting incentives and behaviour of the economic activities, etc.

Government expenditures affect/influence the economy in two ways:

(i) there are some expenditure on government purchases of goods and services, for example construction of roads, railways, ports, foodgrains, etc in the goods category and salary payments to government employees in the services category; and

(ii) there are some expenditure due to government's income support, to the poor, unemployed and old-age people (known as government ***transfer payments***).

Deficit Financing in India

India was declared to be a planned economy right after Independence. As development responsibilities of the government were very high, there was a need of huge funds in rupee as well as in foreign currency forms. India faced continuous crises in managing the required fund to support its Five Year Plans—neither foreign funds came nor internal resources could be mobilised in sufficient amount. (Due to lower tax collections, weaker banks that too privately owned, and negligible saving rate, etc.)[28]

By the late 1960s, the government headed for deficit financing and the 1970s onwards, India started going for higher and higher fiscal deficits and became more and more dependent on increased deficit financing with every fresh year. We may classify dificit financing in India into three phases.

The First Phase (1947–1970)

This phase had no concept of deficit financing and the deficits were shown as Budgetary Deficits. Major aspects of this phase were—

(i) Trying to borrow from inside and outside the economy but unable to meet the target.

(ii) In the 1950s, a serious attempt was made to increase tax collections and check revenue expenditures to be ultimately able to emerge as a surplus revenue budget economy. But huge cost was paid in the form of tax evasion, rise in corruption, stagnating standard of life and a neglected social sector.

(iii) Taking recourse to heavy borrowings from the RBI and finally nationalisation of banks so that their money could be used by the government to support the plans. This not only increased the interest burden of the governments but also ruptured the whole financial system in coming years—banks did not remain commercial entities and became part of the government's political statement.

(iv) Establishing giant PSUs with higher revenue expenditures (salaries) which increased the revenue expenditures of the future governments when the pensions and the PFs needed to be serviced.

(v) Unable to go for the required level of investment even after taking recourse to all the above given means.

The Second Phase (1970–1991)

This is considered the period of deficit financing, follow up of unsound fundamentals of economics and finally culminating in severe financial crisis by the year 1990–91. Major highlights of this phase may be summed up as follows—

(i) This phase saw the nationalisation policy and simultaneous revival of an increased emphasis on expansion of the PSU (two points should be noted here specially—*first*, many of the South East Asian economies have, officially declared their acceptance of capitalism and privatisation. *Secondly*, China had declared that investment in the government-controlled companies are a loss of money at this time).

(ii) Upcoming PSUs increased the total expenditure of the government's revenue as well as capital.

(iii) Existing PSUs were taking their own due from the economy—the illogical employment creation excessively increased the burden of salaries, pensions and PF; many of them had started fetching huge losses by this time; as the public sector does not have profit as its primary goal; there was a lack of profit and loss analysis; as the PSUs had no connection between their need of labour force and the existing labour force. Ultimately the responsibility of profit or loss did not remain the onus of the officers, thus making them centres of intentional losses and an institutionalised centre of corruption; etc.

(iv) The governments have failed on both the fronts—checking population rise and mass employment generation—the burden of different *subsidies* went on increasing making them unmanageable and highly illogical. Self-employment programmes could not pick up, or better said, it was politically suitable to go for piece-meal wage-employment programmes with different names.

(v) Planned development remained highly centralised and devoid of any place for local aspirations—frustrations of masses started showing up in the form extremist and radical organisations raising their heads creating a law and order problem and excessive expenditure on them. The outcome was a burdened police force and lagging judicial set up.

(vi) The plan expenditure which governments were going for were through investments in the PSUs which were not committed to profit motive, deficit financing for the PSUs was not based on sound economics. Majority of the plan expenditure in a sense turned out to be non-economic, i.e., non-plan expenditure at the end.

Due to the above-given reasons, it was tough to say whether it was sound to go for huge fiscal deficits in India.[29]

The Third Phase (1991 onwards)

This started with the initiation of the economic reforms process under the conditionalities put forth by the IMF (controlling fiscal deficit was one amongst them). As the economy moved from government dominance to market dominance, things needed a restructuring and public finance also needed a touch of rationality. Till date, the government had been doing pure politics with the public money in the name of development. Now the IMF dictated and the economy headed towards greater and greater fiscal responsibility in the coming times. India is better today in this regard but we cannot say that

public finance is based today on the sound principles of economics. But the rigorous process of fiscal reforms aiming at fiscal consolidation started in India.

INDIAN FISCAL SITUATION: A SUMMARY

In December 1985, the Government of India presented a discussion paper in the Parliament titled 'Long-term Fiscal Policy'. It was for the ***first time*** in the fiscal history of India that we see a long-term perspective coming on the fiscal issue from the government. This also included the policy of government expenditure. The paper was bold enough to recognise the deterioration in India's fiscal position and accepted it among the most important challenges of the eighties—the paper set specific targets and policies to set the things right. This paper was followed by a country-wide debate on the issue and it was in 1987 that the government came ahead with ***two*** bold steps in the direction—

(i) a virtual freeze was announced on government expenditure, and

(ii) a ceiling on the budgetary deficit.

The above steps had a positive impact on the situation but it was temporary as since mid-1988 the situation again started deteriorating. The BoP crisis at the end of 1990 was generated partly by the alarmingly high ***fiscal deficit***[30] and due to a high level of external borrowings. The IMF support to fight the crisis came in but with many macro-economic conditionalities, checking the fiscal meance being a major one among them. With the process of economic reforms which started in 1991–92, the government also announced its comitment to reduce fiscal deficit to 3–4 per cent (of GDP) by the mid-1990s (from the level of about 8 per cent during 1987–90). This step was among the many measures which the government started with the objective of stabilising the economy. We may have a look at India's fiscal situation upto the 1990–91 in the following way:

(i) The fiscal deficits of the central government, after averaging below 4 per cent of GDP till the 1970s started climbing up by being 5.77 per cent in 1980–81, 8.47 per cent in 1986–87 ending up at 7.85 per cent in 1990–91 after being above 7 per cent in the second half of the 1980s.[31]

(ii) The revenue (i.e., current) expenditure of the government (Centre and states combined) increased from 11.8 per cent of GDP to 23 per cent between 1960 and 1990. The revenue receipts of the government also went up on an average of 14.6 per cent in 1971–75 to 20 per cent in 1986–1990. But the gap between revenue receipts and expenditures remained negative —financed largely by domestic borrowings (as a result the interest payments on domestic debt increased from 0.5 to 2.5 per cent of GDP during 1975–90.[32] The revenue deficit went on increasing after 1979–80 and reached the highest level of 3.26 per cent of the GDP in 1990–91.[33]

(iii) The fiscal situation of the states was not good either. State governments which are primarily responsible for health, education and other social services had an aggregate revenue expenditure of 5 per cent of GDP on these accounts while their capital expenditure accounted for 2.5 per cent on social and other sectors.[34] The states' expenditure on social sector went down while their interest payments had increased during the 1980s.[35]

As per the experts, the debt situation in the states would have been even worse, but for the fact that the states, unlike the centre, did not have independent powers to borrow either from the RBI or the market because of the statutory overdraft regulatory scheme.[36] Thus, their deficits have been self-limiting—whenever the states tried to cut down their deficits the care of social sector and capital expenditure suffered and development prospects in the states also suffered.

Now the question arises that why the government has not been able to check the menace of fiscal deficits even though there has been a consensus to do so? ***There are reasons***[37] which can be cited for it:

- ***(i)*** ***Political factor:*** The political lobbies and sectional politics as well as the subsidies are supposed to be one big factor for rising government expenditure. We see this on a higher scale if there is a probable mid-term election or closer to a general election.
- ***(ii)*** ***Institutional factor:*** The administrative size combined with the processes of reporting, accounting, supervising and monitoring getting greater importance than the production and delivery of goods and services.[38]
- ***(iii)*** ***Ethical factor:*** This is a more powerful factor as it easily generates wide public support for the government expenditure. There are many heads of such expenditures such as subsidies (food, power, fertiliser, irrigation, etc.) poverty alleviation programmes, employment generation programmes, education, health and social services. The logic for such expenditure comes from the idea that the government should function as protector of the poor and provider of jobs for them implying that such government expenditures benefit the poor.

It was in 2000 that the double menace of revenue and fiscal deficits got attention from the government at the centre and some constitutional/statutory safeguards looked necessary. Consequently, the Fiscal Responsibility and Budget Management Bill, 2000 was proposed in the parliament.

FRBM Act, 2003

The fiscal policy of an economy has been considered as the building block for enabling macro-environment by the economists, policymakers and the IMF, alike. It does not only provide stability and predictability to the policy regime but also ensures that national resources are allocated in terms of their defined priorities through the tax transfer mechanism.

Unproductive government expenditures, tax distortions and high deficits are considered to have constrained the Indian economy from realising its full growth potential. At the begining of the fiscal reforms in 1991, the fiscal imbalance was identified as the ***root cause*** of the twin problems of inflation and the difficult balance of payments (BoPs) position.[39] Since then the ***medium-term fiscal policy stance*** of the government has been on the following lines:[40]

- (i) reducing the deficits (revenue and fiscal);
- (ii) prioritising expenditure and ensuring that these resulted in intended outcomes; and
- (iii) augumenting resources by widening tax base and improving tax-compliance while maintaining moderate rates.

The fiscal consolidation which followed in 1991 failed to give the desired results as there was no defined mandate for it. Neither was there any statutory obligation to do so.[41] This is why the Fiscal

Reforms and Budget Management Act (FRBMA) was enacted on August 26, 2003 to provide the support of a strong institutional/statutory mechanism. Designed for the purpose of medium-term management of the fiscal deficit, the FRBMA came into effect on July 5, 2004.

The FRBM Bill, 2000 was passed by the Parliament with all political parties voting in favour, and is considered a watershed in the area of fiscal reforms in the country. Main highlights of the FRBMA, 2003 are as given below:[42]

(i) GoI to take measures to reduce fiscal and revenue deficit so as to eliminate revenue deficit by March 31, 2008 (which was revised by the UPA Government to March 31, 2009) and thereafter build up adequate ***revenue surplus.***

(ii) Rules to be made under the Act to specify ***annual targets*** for the reduction of fiscal deficit (FD) and revenue deficit (RD) contingent liabilities and total liabilities (***RD to be cut by 0.5 per cent per annum and FD by 0.3 per cent p.a.***).

(iii) FD and RD may exceed the targets only on the grounds such as national security, calamity or on exceptional grounds.

(iv) GoI not to borrow from RBI except by Ways and Means Advances (WMAs).

(v) RBI not to subscribe to the primary issue of the GoI securities from 2006-07 (it means that these government bonds/papers will become market—based instrument to raise long-term funds by the government).

(vi) Steps to be taken to ensure greater transparency in fiscal operations.

(vii) Along with the Budget and Demands for Grants, the GoI to lay the following ***three statements*** before the Parliament in each financial year:

(a) Fiscal Policy Strategy Statement (FPSS);

(b) Medium Term Fiscal Policy Statement (MTFPS); and

(c) Macroeconomic Framework Statement (MFS).

(viii) The Finance Minister to make ***quarterly review*** of trends in receipts and expenditure in relation to the Budget and place the review before the Parliament.

Follow-up to the FRBMA

The process of fiscal consolidation under FRBMA has been continuous and essentially an incremental one. Some of the important fiscal measures[43] that are being implemented by the government are as given below:

(i) reducing the peak rates of custom duties;

(ii) rectifying anomalies like ***inverted duty structure;***

(iii) rationalising excise duties with a movement towards a ***medium CENVAT rate;***

(iv) revisiting the tax ***exemptions;***

(v) relying on voluntary tax compliance through taxpayer ***facilitation;***

(vi) introduction of State-level VAT for achieving a ***non-cascading, self-enforcing,*** and ***harmonised*** commodity tax regime;

(vii) increasing productivity of expenditure through an ***outcome budget*** framework (which seeks to

translate outlays into better outcomes through monitorable performance indicators);

(viii) innovative financing mechanism like creation of Special Purpose Vehicle (SPV) for infrastructure projects; and

(ix) states have also joined the process of fiscal consolidation in line with the Twelfth Finance Commission's (TFC) recommendations and are complementing the efforts of the Central Government.

In 2006–07, in case of the ***Central government,*** proposed reduction in revenue and fiscal deficits were put at 0.6 per cent and 0.5 per cent, respectively (higher than the FRBMA Rules), though the reduction suffered in 2005–06 due to higher devolution to states by centre on account of the TFC recommedations.[44]

States also showed considerable improvement (in fact, even better then the central government). The fiscal deficit of the states declined by 1.6 per cent post FRBMA from 4.5 per cent in 2003–04 to 2.6 per cent in 2006–07 of their GDP. Revenue deficit, on an aggregate basis, was budgeted to get eliminated by 2006–07, two years ahead of the target. (***A strong incentive-based restructuring scheme of fiscal transfers to states suggested by the TFC appears to have succeeded***.)[45]

LIMITING GOVERNMENT EXPENDITURE

Elected governments are composed of different interest groups and lobbies. At times, such governments might intend to use its economic policies in a highly populist way for greater political mileage without caring for the national exchequer. Such acts might force the governments to go in for excessive internal and external borrowing and printing of currency. Governments generally avoid to increase tax or impose new taxes for their revenue increase as such acts are politically unpopular. On the other hand, borrowings and printing of currency impose no immediate economic or political costs. A government in the election-year usually spends money frugally by borrowings (from the RBI in India) because it is the coming government after the elections who is supposed to repay them. Government expenditures remain higher and expanding due to some economic reasons also—by doing so extra employment is generated and the output (GDP) of the economy is also boosted. If governments go for anti-expansionary fiscal and monetary policies with the objective of reducing its expenditures the employment as well as the GDP both will be hampered. This is considered a ***bias*** in the economic policies of the elected governments. But there has always been a consensus among the experts and policymakers that an external (i.e., outside the government) and some form of a statutory check must be over the government on its powers of money creation (i.e., by borrowings or printing). With the objective of removing the bias—to make fiscal policy less sensitive to electoral considerations, several countries had introduced some legal provisions on their governments before India enacted its FRBMA. We see mainly ***three variants*** of it around the world:

(i) It was *New Zealand* which ***first*** introduced such a legal binding on the government's powers of money creation. Here the central bank is legally bound to ensure that money creation by the government does not increase the rate of ***inflation target***—it means that the central bank has the overriding powers on the government there in the area of extra money creation.[46]

(ii) The ***second variant*** is putting some firm legal or constitutional limit on the size of government deficits or the power of the government to borrow. *Germany* and *Chile* had such an arrangement—today Germany is bound to the fiscal limits prescribed by the Maastricht Treaty. In the late 1990s, an upper limit on the government's powers to create deficit was introduced.[47]

(iii) Some countries introduced the so-called ***'Currency Board'*** type of arrangement to serve the same purpose—this is the ***third variant.*** In this arrangement, money supply in the economy is directly linked to changes in the supply of foreign assets—neither the government nor the central bank has any independent powers to create money, as growth in money supply is not allowed to exceed growth in the foreign assets.[48]

It was in 1994 that India took the first step in this direction when the central government had a formal agreement with the RBI to limit its borrowing through ***ad hoc*** treasury bills to a predetermined amount (Rs. 6,000 crores in 1994–95).[49] However, it was a highly liberal arrangement with the government having the ultimate powers to revise the aforesaid predetermined amount by a fresh agreement with the RBI. The importance this beginning had was finally in the enactment of the FRBMA 2003—a historic achievement in the area of fiscal prudence in the country.

FISCAL CONSOLIDATION IN INDIA

The average combined fiscal deficits, of Centre and states after 1975, had been above 10 per cent of the GDP till 2000–01. More than half of it had been due to huge revenue deficits. The government were cautioned by the RBI, the Planning Commission as well as by the IMF and the WB about the unsustainability of the fiscal deficits. It was at the behest of the IMF that India started the politically and socially painful process of fiscal reforms, a step towards fiscal consolidation.[50] A number of steps were taken by the government at the centre in this direction and there had been incessant attempts to do the same in the states' public finances too. Major highlights in this direction can be summed up as given below:

1. Policy initiatives towards cutting revenue deficits:

(i) Cutting down expenditure—

(a) Cutting down the burden of salaries, pensions and the PFs (down-sizing/right-sizing of the government, out of every 3 vacancies 1 to be filled up, interest cut on the PF, pension reforms-PFRDA, etc.);

(b) Cutting down the subsidies (Administered Price Mechanism in petroleum, fertilisers, sugar, drugs to be rationalised, it was done with mixed successes);

(c) Interest burden to be cut down (by going for lesser and lesser borrowings, pre-payment of external debts, debt swaps, promoting external lending, minimal dependence on costlier external borrowings, etc.);

(d) Defence being one major item of the expenditure bilateral negotiations initiated with China and Pakistan (the historical and psychological enemies against whom the Indian defence preparedness was directed to, as supposed) so that the defence force cut could

be completed on the borders, etc;

(e) Budgetary supports to the loss-making PSUs to be an exception than a rule;

(f) Expenditure reform started by the governments in different areas and departments;

(g) General Services to be motivated towards profit with subsidised services to the needy only (railways, power, water, etc.);

(h) Postal deficits to be checked by involving the post offices in other areas of profit;

(i) Higher education declared as non-priority sector; fees of institutions of professional courses revised upward; etc.

(ii) Increasing *revenue receipts*:

(a) Tax reforms initiated (Cenvat, VAT, Service Tax, GST proposed, etc.);

(b) The PSUs to be disinvested and even privatised (if a political concensus reached which alludes today);

(c) Surplus forex reserves to be used in external lending and purchasing foreign high quality sovereign bonds, etc.

(d) State governments allowed to go for market borrowing for their plan expenditure, etc.

2. The borrowing programme of the government—

(i) The Ways and Means Advances (WMA) scheme commenced in 1997 under which the government commits to the RBI about amount of money it will give as part of its market-borrowing programme, to bring the transparency in public expenditure and to put a political responsibility on the government.

(ii) The RBI will not be primary subscriber to government securities in the future—committed way back in 1997.

3. The fiscal responsibility on the governments:

(i) The Fiscal Responsibility and Budget Management (FRBM) Act was passed in 2003 (voted by all political parties) which puts constitutional obligation on the government to commit so many things as fiscal responsibility comes in the public finance—fixing annual targets to cut revenue and fiscal deficits; the government not to borrow from the RBI except by the WMA; government to bring in greater transparency in fiscal operations; along with the Budget the government to lay statements regarding fiscal policy strategy in the House and Quarterly Review of trends of receipts and expenditures of the government.

(ii) A mechanism (to include state governments under the umbrella of fiscal responsibility) was advised (now implemented, too) by the 12th Finance Commission which allows the state governments to go for market borrowing (without central permission) for their need of plan development provided they pass their fiscal responsibility acts (FRAs) and commit to the fiscal responsibility regarding cutting their revenue and fiscal deficits. As many as 19 states have already passed their FRAs by now.

At present, we cannot conclude that once the FRBM Act is passed the fiscal abberations will be automatically checked. At the same time, we cannot say whether it will hamper the social cause. But experts agree upon that at least a legislative beginning has taken place and the opposition in the House must have got a tool (and so the people) to create enough democratic pressure on the governments of

the time regarding fiscal prudence.

ZERO-BASE BUDGETING

The idea of zero-base budgeting (ZBB) first came to the privately owned organisation of the USA by the 1960s. This basically belonged to a long list of guidelines for managerial excellence and success, others being Management by Objectives (MBO), matrix Management, portfolio Management, etc to name a few.[51] It was the US financial expert ***Peter Phyrr*** who first proposed this idea for government budgeting and Jimmy Carter, Govornor of Georgia, USA was the first elected[52] executive to introduce ZBB to the public sector. When he presented the US Budget in 1979 *as the US President* it was the first use of the ZBB for any nation state. Since then many governments of the world have gone for such budgeting.

Zero-base budgeting is the allocation of resources to agencies based on periodic re-evaluation by those agencies of the need for all the programmes for which they are responsible, justifying the continuance or termination of each programme in the agency budget proposal—in other words, an agency reassesses what it is doing from top to bottom from a hypothetical ***zero base.***[53]

There are three essential principles of the ZBB. Some experts say it in a different way there are three essential questions which must be answered objectively before going for any expenditure as per the techniques of ZBB:

(i) Should we spend?

(ii) How much should we spend?

(iii) Where should we spend?

There are *three* special features of this budgeting which distinguishes it from the traditional budgeting. These features, in brief, are as under:

(i) The conventional aggregate approach is not applied in it, in which each department of the government prepares their own budget for many activities in the aggegate and composite form, making it difficult to scrutinise each and every activity. In place of it every department needs to justify its existence and continuance in the budget document by using the mathematical technique of econometrics, i.e., cost-benefit analysis. In a nutshell, every activity of each department is 'X-rayed' and once the justification is validated they are allocated the funds.

(ii) *Economy* in public expenditure is the *raison d'etre* of this budgeting. This is why the ZBB has provisions of close examination and scrutiny of each programme and public spending. Finally, the public spending is cut without affecting the current level of benefits of various public services accruing to the public.

(iii) *Prioritising* the competing needs is another special feature of ZBB. Before allocating funds to the different needs of the economy, an order of priority is prepared with utmost objectivity. As the resources/funds are always scarce, in the process of prioritised allocation, the item/items at the bottom might not get any funds.

Side by side its benefits, there are certain ***limitations*** too before the ZBB which prohibits its assumed success, according to experts. These limitations have made it subject to criticisms. The

limitations are as given below:

(i) There are certain expenditures upon which the government/parliament does not have the power of scrutiny (as the 'Charged Expenditure' in India).

(ii) There are certains public services which defy the cost-benefit analysis—defence, law and order, foreign relations, etc.

(iii) Scrutiny is a subjective matter and so this might become prey to bias. Again, if the scrutinisers have a complete utilitarian view many long-term objectives of budgeting and public policy might get marginalised.

(iv) It has scope for emergence of the Ministry of Finance as the all-powerful institution dictating other ministries and departments.

(v) Bureaucracy does not praise it as it evaluates their decisions and performances in a highly objective way.

Despite the above-given strong limitation, the ZBB has a sound logic and should be considered a long-term budgetary reform process. The basic idea of this form of budgeting is to optimise the benefits of expenditure in every area of activity and in this sense it is exceptional. To the extent the corporate world is concerned, this has been a very successful financial management tool.

In India, it is believed to be in practice since 1997–99. We cannot say that India is a success in ZBB, but many of the profit-fetching PSUs have been able to use it successfully and optimise their profits.

RESULTS-FRAMEWORK DOCUMENT (RFD)

In September 2009, the Indian PM approved the outline of a ***Performance Monitoring and Evaluation System (PMES)*** for government ministries/departments. Under PMES, each ministry/department is required to prepare a Results-Framework Document (RFD). It has been adopted by the GoI to monitor the performance management of various ministries/departments. The RFD system is being implemented in various ministries/departments in phased manner – was implemented to 59 ministries/departments for the year 2009-10, increasing every year in 2013-14 it will get implemented in 84 ministries/departments. ***Performance Management*** in the government is a *new concept* which determines the performance index based upon the agreed objectives, policies, programme and projects/schemes. To ensure the success in achieving the agreed objectives and implementing agreed policies, programme and projects, the RFD also includes a commitment for required resources and necessary operational autonomy.

A 'RFD provides a summary of the most important results that a organization expects to achieve during the financial year'. The document has two main purposes –

(i) Move the focus of the organization 'from process-orientation to results-orientation'; and

(ii) provide an objective and fair basis to evaluate organization's overall performance at the year-end.

The RFD Guidelines are divided into ***three broad sections:*** **1.** Format of RFD; **2.** Methodology for Evaluation; and **3.** RFD Process and Timelines

1. Format of RFD

A Results-Framework Document (RFD) is essentially a record of understanding between a department/ministry representing the people's mandate, and the Head of the organisation responsible for implementing this mandate. This document contains not only the agreed objectives, policies, programme and projects but also success indicators and targets to measure progress in implementing them. To ensure the successful implementation of agreed actions, RFD may also include necessary operational autonomy. In the case of the Responsibility Centres (attached offices, subordinate offices, and autonomous organisations), the RFD will represent a record of understanding between the parent department/ministry and the Responsibility Centre. The RFD seeks to address ***three basic questions***:

(i) What are organisation's main objectives for the year?

(ii) What actions are proposed to achieve these objectives?

(iii) How would someone know at the end of the year the degree of progress made in implementing these actions? That is, what are the relevant success indicators and their targets?

The RFD should contain the following ***five sections***:

(i) Organisation's Vision, Mission, Objectives and Functions.

(ii) *Inter se* priorities among key objectives, success indicators and targets.

(iii) Trend values of the success indicators.

(iv) Description and definition of success indicators and proposed measurement methodology.

(v) Specific performance requirements from other departments/organisations that are critical for delivering agreed results.

2. Evaluation Methodology

At the end of the year, the parent ministry/department will look at the achievements of the organisation, compare them with the targets, and determine the composite score. The composite score shows the degree to which the organisation in question was able to meet its the promised results, i.e., *objective*. Various agencies will have a diverse set of objectives and corresponding success indicators. Yet, at the end of the year every organisation will be able to compute its composite score for the past year.

3. RFD Process and Timelines

Beginning of the Year: At the beginning of each financial year, each organisation to prepare a RFD. And as per the priorities listed in the RFD, proposed activities and the corresponding success indicators to be approved. The RFDs draft has to be completed by 5th of March for feedback and finalised by 31st March every year – the final versions of all RFDs to be put on the websites by the 15th of April each year. The final RFD to take into account budget provisions and in particular the *Outcome Budget*. The RFDs to be drawn up in such manner that quarterly monitoring is possible.

During the Year: After six months, the Results-Framework as well as the achievements to be reviewed – the RFDs may be reviewed and the goals reset, taking into account the priorities at that point of time (this will enable to factor in unforeseen circumstances such as drought conditions,

natural calamities or epidemics). Cabinet Secretariat to select about 24 RFDs using a stratified random sampling procedure to examine them.

End of the Year: At the end of the year, all RFDs to be reviewed, a report listing the achievements of their respective organisations against the agreed results in the prescribed format. This report is required to be finalised by the 1st of May each year. After scrutiny by the concerned administrative ministry/department, these results will be placed on the website by 1st of June each year.

The RFD is among the attempts by which government have been trying to bring in higher performance in its ministries/departments together with 'transparency', 'accountability' and 'responsibility'. This is in the series of other such initiatives like 'Outcome Budgeting' and 'Performance Budgeting'. The 'Zero-Base Budgeting' was a similar and first such initiative in this direction taken by the GoI in mid-1990s.

CHARGED EXPENDITURE

It is the public expenditure which is beyond the voting power of the Parliament and is directly withdrawn from the Consolidated Fund of India.[54] The emoluments of the President, Speaker and Deputy Speaker of the Lok Sabha, Chairman and Deputy Chairman of the Rajya Sabha, Judges of the Supreme Court and the High Courts, etc. in India, for example.

TYPES OF BUDGETS

Golden Rule

The proposition that a government should borrow only to invest (i.e., plan expenditure in India) and not to finance current spending (i.e., revenue expenditure in India) is known as the golden rule of public finance. This rule is undoubtedly prudent but provided spending is honestly described as investment, investments are efficient and does not crowd out the important private sector investments.[55]

Balanced Budget

A budget is said to be a balanced budget when total public-sector spending equals total government income (revenue receipts) during the same period from taxes and charges for public services.[56] In other terms, a budget with zero revenue deficit is balanced budget. Such budget making is popularly known as *balanced budgeting*.

Gender Budgeting

A general budget by government which allocates funds and reponsibilities on the basis of gender is gender budgeting. It is done in an economy where socio-economic disparities are chronic and clearly visible on a sex basis (as in India).

Gender budgeting started in India with the Union Budget 2006–07 which proposed an outlay of Rs. 28,737 crore dedicated to the cause of women and created gender budgeting cells in 32 ministries and departments.[57]

Outcome and Performance Budgets[58]

The concepts are part of result-oriented budgeting. While outcome budget is presented by different departments and divisions of a ministry or the government, the performance budget is presented by the Ministry of Finance on behalf of the government. Both go for ‘quantitative’ as well as ‘qualitative’ progress reports of the performance. The outcome budget is a micro level process while performance budget is a macro level process in budgeting. There are many outcome budgets in any one performance budget.

The basic objective of such budgeting is to bring in transparency and thereby making the government more and more responsible to the House and the public. Naturally, they bring in prudence and optimisation elements in public spending (also see entry ‘Outcome Budget’ in Chapter 24).

CUT MOTION

In democratic political systems, there is a provision of Cut Motion in the House/Parliament (usually it is the opposition but floor might be crossed by members of the House belonging to the government due to presence of inner-party politics). In the US, the budget provisions presented by the government must be passed by the Congress. Only then they can be enacted. Unlike this, in the British parliamentary system though the budget of the government is voted by the House usually this is considered a political document and passed unchanged. India has mixed provisions of voting on the budget after discussion in both the Houses. There are different constitutional provisions by which the Parliament starts discussion on the demands, grants, etc. proposed by the government in the Budget[59] —

(i) *Token Cut* is a cut of ‘100 by the House from the total demand made by the government.

(ii) *Economy Cut* is a cut of specific amount from the total demands made by the government.

(iii) *Disapproval of Policy Cut* is cutting just ‘1 from the total government demands made in the budget. It is a symbolic cut.

(iv) *Guillotine* is the most severe form of the cut motion in which demands by the budget are directly put to vote *without any discussion or scrutiny.* This is the most radical form as it might culminate in the fall of the government—a kind of no confidence motion. Floor-crossing is an imminent danger in this. However, it has never happened in the Indian fiscal arena.

TRILEMMAS

Putting the right kind of fiscal policy has always been the most challenging policy decision to be taken by the democratic governments around the world there are some famous ‘trilemmas’ related to this

aspect. Economics have by now many 'trilemmas' developed and articulated by economists from time to time and the process still continues. Let us see some highly popular and newsmaking ones:

(i) The **'financial stability trilemma'** put forward by Dirk Schoenmaker[60] (2008), explains the incompatibility within the euro zone of – **(a)** a stable financial system, **(b)** an integrated financial system, and **(c)** national financial stability policies.

(ii) By far the most high profile current trilemma of the euro-zone (by Edward Chancellor[61]) was believed to be the seeming irreconcilability between its **three wishes,** namely, **(a)** a single currency, **(b)** minimal fiscal contribution to bail outs, and **(c)** the ECB's commitment to low inflation.

(iii) Martin Wolf[62] spoke about the US Republican Party's **fiscal policy trilemma: (a)** large budget deficits are ruinous; **(b)** a continued eagerness to cut taxes; and **(c)** an utter lack of interest in spending cuts on a large enough scale.

(iv) Then we have the **Earth Trilemma** (EEE), which posits that for: **(a)** economic development (E), **(b)** we need increased energy expenditure (E), **(c)** but this raises the environmental issue (E).

(v) Above all these more recent trilemmas in economics, the prima donna of all of them is Mundell's **'impossible trinity'**. This old trilemma asserts that a country cannot maintain, simultaneously, all three policy goals of – **(a)** free capital flows, **(b)** a fixed exchange rate, and **(c)** an independent monetary policy. The impossible trinity, has seen enough waters flowing down the time since it was articulated almost five decades ago which has a strong theoretical foundation in the *Mundell-Fleming Model* developed in the 1960s.

Dani Rodrik[63] argued that if a country wants more of globalisation, it must either give up some democracy or some national sovereignty. Niall Ferguson[64] highlighted the **trilemma** of a choice between commitment to globalisation, to social order and to a small state (meaning limited state intervention).

TREASURY COMPUTERISATION OF STATE

Governments

A scheme for implementation of the mission mode project[65] 'Computerisation of State Treasuries' was put in place by the GoI in June 2010 under the ***National e-Governance Plan (NeGP)***. The states and UTs are required to complete their projects in about three years beginning 2010-11. The funds are released against deliverables. The scheme will support states and UTs to fill the existing gaps in their treasury computerisation, upgradation, expansion and interface requirements, apart from supporting basic computerisation. The Scheme covers installation of suitable hardware and application software systems in a networked environment on a wide area basis and building of interfaces for data sharing among various stakeholders.

The scheme for treasury computerisation is expected to make the budgeting process more efficient, improve cash flow management, promote real-time reconciliation of accounts, strengthen management information systems (MIS), improve accuracy and timeliness in accounts preparation, bring about

transparency and efficiency in public delivery systems, help bring about better financial management along with improved quality of governance in states and UTs. The overall estimated cost of the scheme is Rs. 626 crore at Rs. 1 crore per district in existence on 1 April 2011. Financial support is up to 75 per cent (90 per cent in case of northeastern states) of the individual project cost of admissible components limited to Rs. 75 lakh per district (Rs. 90 lakh per district for north-eastern states). Funds will be released as central assistance in three instalments of 40 per cent, 30 per cent, and 30 per cent each, subject to satisfactory receipt of utilisation certificates.

CRIS OF INDIA

The Finance Ministry of India has developed and released *(January 31, 2012)* the ***Comparative Rating Index of Sovereigns (CRIS)*** *– a new index of sovereign credit rating.* Together with it, the Ministry has also released an estimation of CRIS over the **last five years**, for **different nations** belonging to different blocks of the global economy.

Major credit rating agencies give out the sovereign credit rating of each nation as an absolute grade. How other nations fare does not matter in a particular nation's rating score. The CRIS is very different from a comparative rating. An example of comparative rating is the percentile score – the way *GRE (Graduate Record Examination)* results are at times given. If a student is described as belonging to the 99th percentile, it clearly says something about this student's performance vis-à-vis other students.

It is arguable that even for sovereign credit ratings, there is a case for providing some kind of a comparative score. When an investor searches across nations for a place to put her money, the relative rating of nations is important. If nation **y's** rating remaining the same, other nations' ratings improve over time, there may well be a case to invest less in nation **y.**

The computation of CRIS is based on nothing apart from ***Moody's*** ratings and data on the GDPs of different nations as given by the ***IMF***. In the paper, the Ministry defines the CRIS formally and then track how nations have done over time. In order to capture this impact, the Ministry of Finance developed a new system for comparing the relative ratings of sovereign debt based on the historical evolution of their ratings over five years and the volume of their economic activity as measured by their GDP (not adjusted for Purchasing Power Parity (PPP)). The Finance Ministry develops a relative rating index and rank 101 economies according to this for the years 2007 to 2011. The index uses external data on GDP and ratings combined in terms of pure mathematical and statistical methods without interventions or interpretations.

THE ECONOMY TODAY: 2013-14

Global financial crisis has taken its toll on the Indian economy in a great way. As per the latest *World Oultlook* released by the *World Bank*, situation looks a little bit improving. In the case of India, the financial year 2012-13 has been completed and the new year., i.e., 2013-14 has already commenced, the fiscal situation of the economy has shown *symptoms of revival* – as has been announced by the

Finance Minister, the Chief Economic Advisor to the MoF, the RBI, the Prime Minister's Economic Advisory Council – almost all who matter in the case of India are optimistic – and so is the business and industry. The present fiscal situation of the economy is being highlighted here briefly.[66]

Non-Tax Revenue

According to the latest *Economic Survey 2012-13*, non-tax revenues grew at a compound annual rate of **7.6** per cent in the 10 years ending 2009-10. The spurt in 2010-11 owed to higher-than-budgeted realisation from the proceeds of auction of telecom 3G/broadband wireless access spectrum. As against the estimated revenue of Rs. 1,25,435 crore in 2011-12 (BE), the realisation fell marginally short at Rs. 1,24,307 crore notwithstanding the fact that the *auctions of telecom spectrum* and Phase III FM Radio which were to bring in Rs. 14,600 crore could not take place.

Budget 2012-13 estimated a growth of **32.0** per cent over 2011-12 in non-tax revenue (mainly on account of estimated receipts of Rs. 40,000 crore from the telecom spectrum auction). As the 2G telecom spectrum auction elicited ***lukewarm response*** on account of the high reserve price in the current year, the government has revised the reserve price downwards. As such, the proceeds from this component are as yet an important risk to the actual fiscal outcome for 2012-13. The other main component is *dividends* and *profits* from PSUs which also remained sluggish.

Non-Debt Capital Receipts

Recoveries of loans and disinvestment are the two key receipts of the non-debt capital variety which have remained subdued through the past two years – as per the latest *Economic Survey 2012-13*. As against Rs. 16,897 crore in 2011-12, Budget 2012-13 had placed recoveries of loans at Rs. 11,650 crore. The *12th Finance Commission's* recommendation against loan intermediation from the centre to states, coupled with the fact that such recoveries of loan have become a minor source in the receipts side has resulted in *disinvestment* assuming greater importance.

As against Rs. 40,000 crore budgeted under disinvestment in 2011-12, actual receipts were Rs. 15,622 crore on account of the subdued financial market conditions. The Budget for 2012-13 has estimated that Rs. 30,000 crore would accrue in 2012- 3. In April-December 2012, receipts under this head were Rs. 8,178 crore.

The government has taken several steps to expedite the process of disinvestment. The Cabinet Committee on Economic Affairs has approved disinvestment in some of the big profit-making PSUs recently together a proposal of Exchange-Traded Fund (ETF) for the stocks of the listed PSUs.

Expenditure Trends

Given the large unmet minimum needs of development, and factoring in the resource availability, the annual budgets estimate the expenditure to be incurred for the year with due consideration to the level of fiscal deficit that is required under the FRBM mandate. Rapid reduction in expenditure as part of fiscal consolidation is constrained by the level of committed expenditure on interest payments, defence, civil service pay and pensions, etc., which appropriate large part of the revenue receipts on the one hand, and the need to step up development expenditure that is so critical for raising the level

of welfare of the masses on the other.

Thus, the annual budget has to maintain a *delicate balance* between the need to reduce the expenditure that is perceived as non-developmental, given the structural rigidities in the key expenditure components and the needs for raising the levels of development expenditure for inclusive growth. It is in this context successive budgets have focused on 'reprioritisation of expenditure'.

In the post-FRBM period, prior to the global crisis, total expenditure as a proportion of GDP was brought down from **15.4** per cent in 2004-05 to **13.6** per cent in 2006-07. Following the global crisis and the fiscal stimulus that followed, this proportion rose in excess of **15.7** per cent in 2008-09 and **15.8** per cent in 2009-10. Notwithstanding the significant fiscal consolidation achieved in 2010-11 when the stimulus measures were partially rolled back, total expenditure as a proportion of GDP was placed at **15.4** per cent, which was possible due to the one off nature of surge in non-tax revenues from '3G/BWA telecom spectrum auction/proceeds' as well as high levels of nominal GDP.

Subsidies

The Budget for 2011-12 had estimated total subsidies expenditure to be contained at **14.0** per cent of GDP, but as there was an overshooting on account of the high global oil prices and the insufficient pass through to domestic oil and fertilizer prices. The overshooting of expenditure on subsidies was also because of the accounting changes which placed all subsidies 'above the line'. The Budget for 2012-13 estimated growth in total expenditure at **13.1** per cent over 2011-12 and sought to restrict expenditure on subsidies to ***2 per cent of GDP*** (as against a provision of Rs. 23,640 crore in 2011-12 for oil subsidies, the Budget for 2012-13 provisioned an amount of Rs. 43,580 crore assuming a certain level of global crude oil price).

In the event, the Indian basket crude oil was $107.52 per bbl (April-December) in 2012 and even with the pass through effected in the course of the year, under-recoveries of OMCs surged and were estimated at Rs. 1,24,854 crore during April-December 2012-13. As the bulk of the under-recoveries is accounted for by two subsidised products, viz. **diesel** and **LPG**, the government raised diesel prices by Rs. 5 per litre and capped the subsidised cylinders at *six* per connection per year in September 2012. With continued rise in prices, on ***January 17, 2013*** the government further permitted OMCs to raise *diesel prices* in small measures periodically. However, in order to protect household budgets, it simultaneously raised the annual LPG cap from *six to nine* cylinders per connection.

The high level of global crude oil prices also has a significant bearing on the level of **fertilizer** subsidies because it is not only a key input as feedstock, but also because there is inadequate pass through in urea (the major domestic fertilizer) prices. Subsidy on fertilizers had increased substantially from Rs. 32,490 crore in 2007-08 to reach Rs.60,974 crore in 2012-13 (RE). The government has been calibrating pricing policies to address the issue of burgeoning fertilizer subsidies. One of the important decisions taken was to fix per tonne subsidy on key non-nitrogenous fertilizers, thereby limiting the increase in subsidy outgo to the extent of increase in consumption.

Another major subsidy outgo in recent years, growing at an annual average rate of 25.4 per cent in the last five years ending 2011-12, is on account of **food**. While the targeted public distribution system (TPDS) accounts for the bulk of the food subsidy outgo, there are other welfare schemes under which food subsidy is provided. A part of the subsidy outgo also owes to the carrying cost of the *buffer*

stock, which has mounted in recent years. In terms of the merits of subsidisation, priority needs to be accorded to food subsidy in view of the under-consumption of basic food by the poor and the extent of malnutrition in the country. The government has sought to correct this through the National Food Security Act, though concerns have been expressed that this will lead to a higher subsidy outgo. However, it is a part of the challenge of *prioritisation* to provide for this basic minimum need even as other items of expenditure are minimized. Further, there is need for better targeting of subsidies and for reducing leakages involved in their delivery.

Direct Benefit Transfer (DBT)

The DBT plan was introduced on ***January 1, 2013*** with seven schemes in 20 districts. India has embarked on a DBT scheme in selected districts wherein it has been envisaged that benefits such as scholarships, pensions, and MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) wages will be 'directly credited' to the bank or post office accounts of identified beneficiaries. The DBT scheme *will not substitute* entirely for delivery of public services for now. It will replace neither food and kerosene subsidies under the TPDS nor fertilizer subsidies. The DBT is ***designed*** to –

(i) improve targeting,
(ii) reduce corruption,
(iii) eliminate waste,
(iv) control expenditure, and
(v) facilitate reforms.

Electronic transfer of benefits is a simple design change and transfers that are already taking place through paper and cash mode will now be done through electronic transfers. This has been enabled by rapid roll out of *Aadhar* (Unique Identity) now covering 200 million people and rapidly growing to cover 600 million (nearly half of our population), with the *National Population Register (NPR)* covering the other half of the populace. The DBT in tandem with such unique identification will ensure that the benefits reach the target groups faster and minimize 'inclusion' and 'exclusion' errors as well as 'corruption' that are associated with manual processes.

Interest Payments

The cumulative impact of the level of deficit and debt is reflected in the interest payments outgo. As a proportion of GDP, interest payments fell in the post FRBM period and have continued to be low at around **3.1** per cent in recent years notwithstanding the rise in fiscal deficit. A part of this owed to lower growth in interest payments visà-vis nominal GDP. As against an average annual growth of **12.7** per cent in interest payments in the last five years ending 2011-12, annual average nominal GDP growth was **15.9** per cent.

It would be instructive to note that the base for interest payments is the cumulative debt in the previous year plus the incremental assumption of debt in the current year. The average ***cost of borrowing*** thus measured is placed at **7.9** per cent in 2011-12 and was budgeted to remain at the same level in 2012-13.

Pay Allowances and Pension

Pay and allowances constituted **0.9** per cent of GDP in 2007-8, rising to 1.4 per cent of GDP in 2009-10 on account of the implementation of the award of the *Sixth Central Pay Commission*. For 2011-12 it was at **1.1** per cent of GDP – but some moderation has been there and is estimated to be at **1.0** per cent for the 2012-13 (RE).

Similarly, pension constituted **0.5** per cent of GDP in 2007-8 and rose to 0.9 per cent in 2009-10; it is placed at **0.6** per cent in 2011-12 and 2012-13. A longer time trend analysis reveals that growth in pensions was very modest prior to 2004-05 and subsequently picked up due to the impact of the contributory scheme (i.e., the New Pension Scheme) introduced for fresh entrants to government service in addition to the outgo under the earlier pension scheme with undefined contribution. In tandem with pay and allowances, pensions also grew sharply in 2008-09 and 2009-10, reflecting the impact of the Sixth Pay Commission.

States' Finances

While there has been some stress in central government finances in recent years, the finances of states are in **fine fettle**. The combined gross fiscal deficit of states did not exceed **3.0** per cent of GDP even in the years of global crisis. After reaching a level of **1.5** per cent of GDP in 2007-8, the fiscal deficit of states rose to 2.9 per cent in 2009-10 but has moderated to **2.1-2.3** per cent subsequently.

As a proportion of GDP, *tax receipts* moderated in 2008-09 and 2009-10 and together with stable non-tax receipts helped in fiscal consolidation notwithstanding a small rise in 2011-12. With the exception of 2009-10, the combined position of states in terms of *revenue deficit* has been one of ***surplus***.

Besides, what is noteworthy is that there has been an improvement in the *quality of expenditure* with a rise in capital expenditure to GDP ratio and development expenditure. However, as with many other economic indicators, there are large inter-state variations in the attainments in terms of fiscal outcome.

One concern arising from state finances is that there is incomplete information on extra-budget activities and quasi-fiscal activities. The ***RBI's Study of State Budgets 2012-13*** has indicated that notwithstanding the information gap, fiscal transparency at state government levels has increased. One of the main problems with states' finances is in the financial health of the ***power distribution*** companies, which continue to accumulate huge losses [estimated at Rs. 1,90,000 crore at end-March 2011] – mainly on account of:

(i) Non-revision of tariffs,

(ii) Subsidy arrears,

(iii) High aggregate and technical losses, and

(iv) the high cost of buying short-term power.

Thus, continued reform initiatives are critical for maintaining sound finances of the states – recently *(mid-April 2013),* the GoI approved a loan component to the loss-making state electricity boards (SEBs) for the 'restructuring and reforms' of their power sectors.

SPECIAL CATEGORY STATES

The term Special Category States (SCS) has been in ***news*** for the past many years, specially since a new state of Jharkhand was carved out of the then Bihar – the new Bihar has been demanding such a status from the Centre – the present government in Bihar has always put this demand – before the General Elections of 2014, the government there put a condition on which it may think joining an Alliance forming the Central Government in the post-2014 times. Recently, the matter has been included by the GoI in the *Union Budget 2013-14* and the government has conveyed that it is 'considering such a status for Bihar' – whatever be the complusions/realities of the contemporary real politik, hereby, let us try to understanding the idea of the ESCS.

The Special Category States (SCS) have some common characteristics like international boundary, hilly landscape, geographic and socio-economic backwardness with low capability to generate adequate income from available resources etc. Presently, 11 states come under this category- seven States of North-Eastern region, Sikkim, Jammu & Kashmir, Himachal Pradesh and Uttarakhand. Other states are referred as *General Category States (GCS)*. They are 'special' in the sense that they have special socio-economic, geographical problems, high cost of production with less availability of useful resources and hence low economic base for livelihood activities.

Fiscal Position of the SCS: The SCS are highly dependent on central grants from the Union Government for meeting their financial requirements. These states show a revenue surplus position because any 'expenditure that they make on creating assets out of grants from the Centre is not treated as revenue expenditure'. This is *contrary* to the existing accounting standards which treats all expenditure from grants as revenue expenditure.

Manipur, Nagaland, Sikkim and Uttarakhand have a fiscal deficit which is higher than 3 per cent but less than 6 per cent) of their GSDP and the *13th Finance Commission* has indicated that they have to make efforts to reduce the fiscal deficit to 3 per cent by ***2013-14***. Jammu and Kashmir and Mizoram have higher fiscal deficits and require concerted efforts at reducing their debt stock to achieve targets set by the 13th Finance Commission. The other states Arunachal, Meghalaya, Assam, Tripura and Himachal pradesh have a fiscal deficit which is less than 3 per cent of GSDP and therefore need to maintain their position to achieve the targets set out by the 13th Finance Commission.

Although the 12th Finance Commission recommended that all states (including SCS) should be permitted to borrow from the open market at market rates, the special dispensation given to special category states continues for external loans. In the case of the externally aided projects to SCS, the Union Government treats 90 per cent of the amount borrowed as a grant and only the remaining 10 per cent is a loan. (For the general category states, externally aided projects are funded on a back-to-back basis).

More Central Assistance for SCS: Human Development Index (HDI) is considered as a better indicator of overall development of a state. Central grants are required to ensure/maintain better education and health standards in these states as they may not be able to generate own resources for this purpose due to their economic vulnerability. SCS require more central assistance as some of the SCS's Debt-GSDP ratio is higher than General Category States. High Debt GSDP ratio leads to fiscal vulnerability and poor sustainability of debt related obligations.

The *13th Finance Commission* has recommended a 'Performance Grant' of Rs. 1,500 crore to three SCS, namely Assam, Sikkim and Uttarakhand in recognition of the efforts made by these states to reduce their 'Non-Plan Revenue Deficit' *[Non Plan Revenue deficit = Non Plan Revenue receipts - Non Plan Revenue expenditure]*.

Planning Commission also publishes data regarding SCS central assistance as per 'Gadgil Formula', plan expenditure, fiscal status etc. The North Eastern States out of SCS have been provided special incentives by the Ministry of Development of North Eastern Region (DONER). Moreover, Ministry of Commerce and Industry had been formulated a separate policy named as *North East Industrial and Investment Promotion Policy (NEIIPP), 2007* [earlier known as the North East Industrial Policy (NEIP), 1997] providing incentives for all industrial units to expand industrialisation and development activities in North Eastern states. The Special Incentives packages for Industrial Development of the states like J&K, Himachal Pradesh and Uttarakhand are also implemented by the Ministry of Commerce and Industry.

Government Debt

Due to the global financial crisis, fiscals deicit of the GoI has been expanding which added to its overall debt burden. Prolonged fiscal deficits lead to accumulation of debt beyond levels sustainable for an economy and can result in higher real and nominal interest rates, slower growth in capital formation, and potentially lower rate of output growth. The outstanding liabilities of the central government were placed at Rs. 44,68,714 crore, equivalent of **49.8** per cent of GDP at end-March 2012. As a proportion of GDP, outstanding liabilities (adjusted) of the centre peaked at **67.0** per cent in 2002-03 and have fallen subsequently notwithstanding the rise in fiscal deficit in the post-crisis years. This is on account of the fact that growth in incremental assumption of liabilities has been lower than that of nominal GDP and the debt to GDP ratio dynamics is aided by the 'differential between nominal GDP growth and nominal interest rates', which makes it possible to achieve a greater reduction through a given primary balance.

The total liabilities for the GoI include debt and liabilities accounted for in the Consolidated Fund of India *(technically defined as 'public debt')* as well as liabilities accounted for in the public account. Public debt constitutes 76.3 per cent of total liabilities at the end of March 2012. It is further classified into internal and external debt. Internal debt, constituting **90.9** per cent of public debt, largely consists of fixed tenor, fixed coupon dated *securities* (72.1 per cent) and *treasury bills* (10.2 per cent).

Over time, there is a compositional shift toward ***marketable debt***, while the public account liabilities have seen a commensurate decline. The share of marketable debt to total internal liabilities, which was about 30 per cent in the beginning of the 1990s, increased to 40 per cent in the beginning of the 2000s and is budgeted to increase to 67.5 per cent by ***end-March 2013***. The share of public account liabilities on the other hand is estimated to decline to 22.8 per cent in 2012-13 (BE) from about 30 per cent in 2001-02 and about 46 per cent in the beginning of the 1990s.

More dependence on *domestic debt* insulates the debt portfolio from volatility in international capital markets. It also minimizes currency risk. Apart from this, internal debt of the features which provide some comfort are –

(i) Weighted average *maturity* of outstanding government securities at 9.8 years is high compared to international standards.

(ii) Most of the public debt in India is at fixed interest rates. Of the total outstanding dated securities, only *1.8 per cent* was on floating rate. Thus, interest payments are largely insulated from interest rate volatility, which provides stability to the Budget.

(iii) The average cost of the debt (interest payments/debt ratio) and interest payments as a percentage of revenue receipts are on a secular decline, though some rise was seen in the past two years. 'Ratio of interest payments to revenue receipts' has declined to around *36 per cent* in 2011-12 from about 50 per cent in the beginning of the 2000s.

Consolidated General Government

The fiscal deficit of the Centre in 2012-13 is estimated to be at **5.2** per cent (RE) while for 2013-14 the target is of **4.8** per cent (BE) as per the *Union Budegt 2013-14*. Combined fiscal deficit of states has exhibited a modest 'deterioration' to 2.3 per cent of GDP in 2011-12 and is estimated to be around **2.0** per cent for 2012-13.

The fiscal outcome in terms of 'Consolidated General Government' (Centre and states combined, i.e., 'the fiscal deficit of the Indian economy') was at **8.1** per cent in 2011-12 (RE) as against 6.9 per cent in 2010-11. In 2012-13 (BE), it is budgeted to come down to **7.2** per cent of GDP. While there is a likely ***slippage of 0.2*** percentage point in terms of the Centre's target, the overperformance in states is expected to help in achieving the budgeted levels in the overall fiscal outcome in 2012-13.

Prospects for the Future

The *Mid-Year Economic Analysis 2012-13* sought to allay concerns about the fiscal outcome for 2012-13 through allusion to the measures taken and indicated that the fiscal deficit for the year would be contained at **5.3** per cent of GDP. The outcome in April-December 2012 in terms of fiscal deficit broadly indicates that this is likely to happen notwithstanding the significant shortfall in revenue. The overall shortfall in *non-debt receipts* could be contained with ongoing greater efforts at mobilisation and *reforms* already in place. The longer-term outlook has already been outlined in terms of the fiscal consolidation roadmap leading to a fiscal deficit of **3.0** per cent of GDP in **2016-17** (shown by the Union Budget 2013-14 also). Addressing the key fiscal risk of *petroleum subsidies* is critical in better fiscal marksmanship. With the recent 'reforms in diesel prices' and efforts at expenditure reprioritisation, the medium-term fiscal consolidation plan is credible and could be expected to yield macroeconomic dividends in terms of higher growth and price stability.

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1. L. N. Rangarajan (ed.), ***The Arthashastra,*** Penguin Books, N. Delhi, 1992.
2. The size of government expenditure for the developed economies stood at almost 10 per cent of their GDPs at the begining of the 20th century—which could rise to 18 per cent only at the outbreak of the Second World War—went for a steep rise by 1980 to 40 per cent. The government expenditure was barely 9 percent of the GDP in India at the time of Independence, nearly doubled in 1970s and reach 75 per cent in the 1980s—when questions were raised about their sustainability as revenue receipts failed to grow adequately resulting in rising budgetary deficits (see Amaresh Bagchi (ed.), ***Readings in Public Finance,*** Oxford University Press, N. Delhi, 2005, pp. 1–4).

3. It should be noted here that the world which had the form of the state economy (i.e., the Socialist countries at this time, majority of the economic activities were under government control. As the communist form of the state economy emerged by the late 1940s (i.e., Peoples Republic of China, 1949), it had 100 per cent state control over the economic activities.
4. ***Collins Dictionary of Economics,*** op. cit., & **Oxford Dictionary of Business**, op. cit.
5. Based on the Budgetary documents of the Ministry of Finance, Government of India, N. Delhi.
6. ***Union Budget 1987–88,*** MoF, GoI, N. Delhi.
7. ***Review of the Working of the Monetary System,*** headed by Sukhomoy Chaktravarthy, RBI, GoI, N. Delhi, 1985.
8. Raja J. Chelliah, ***'The Meaning and Significance of the Fiscal Deficit'*** in Amaresh Baghi (ed.), ***Readings in Public Finance,*** op. cit., pp. 387–88. Also see ***Union Budget 1997–98,*** MoF, GoI, N. Delhi.
9. Raja J. Chelliah, op. cit., pp. 381 & 387. Also see ***Union Budget 1997–98,*** MoF, GoI, N. Delhi.
10. ***Union Budget 1997–98,*** op.cit.
11. Raja J. Chelliah, op. cit., P. 389. Also see ***Union Budget 1997–98,*** op.cit.
12. In the US economy if tax revenue falls short of government expenditures, the government has a ***fiscal deficit,*** and it means that the government needs to borrow in the capital market to cover the difference. Opposite to it, if the government runs a ***fiscal surplus*** (i.e. its tax revenues exceed its expenditure) then the government, like the household sector, will be a net saver and will represent a source of saving for the economy (see Stiglitz and Walsh, ***Economics,*** op.cit., p. 549)
13. J. K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1987, p. 226. (***The whole Chapter XVII on J.M. Keynes pp. 221–36 is interesting to refer on the topic***.)
14. For a detailed discussion on the topic one may refer to Joseph. E. Stiglitz, ***Economics of the Public Sector,*** W.W. Norton, 3rd Ed., New York, 2000.
15. It should be noted here that although the governments had run deficits (i.e., budget deficit) even before the Keynesian idea of the deficit, the pre-Keynesian thinking was that in peacetime the budget should generally be ***balanced*** (i.e., neither deficit nor surplus), or even in surplus so that the government debt created by wartime deficits could be paid off. For further reference on the topic and its constraints, Stanley Fischer and William Easterly, ***Economics of the Government Budget Constraints,*** World Bank Research Observer, Vol. 5, No. 2, July 1990, pp. 127–42 see (also reproduced in Amaresh Bagchi (ed.), ***Readings in Public Finance,*** op. cit., pp. 301–19).
16. Ibid. (***Amaresh Bagchi*** ed. op. cit., pp. 305–10).
17. ***Ibid.***
18. ***Ibid.***
19. L.N. Rangarajan, op. cit., pp. 259–62.
20. J. Cullis and P. Jones, ***Public Finance and Public Choice,*** Oxford University Press, New York, 2nd Ed., 1998.
21. The acclaimed definition first came up in the widely used work ***Macroeconomics*** by Dornbusch and Fisher which is now available as R.S. Dornbusch, S. Fisher and Richard Startz, ***Microeconomics,*** Tata McGraw-Hill, N. Delhi, 8th Ed., 2002.
22. John Hicks, the British Nobel Laureate did show it referring changes in taxes and government expenditure using the framework of the famous IS-LM model (*Ibid*).
23. S. R. Maheshwari, ***A Dictionary of Public Administration,*** Orient Longman, N. Delhi, 2002, p. 227.
24. In his acclaimed work ***The General Theory of Employment, Interest and Money,*** 1936.
25. Stiglitz and Walsh, ***Economics,*** op. cit., p. 729.
26. Samuelson and Nordhaus, ***Economics,*** op.cit., p. 412.
27. Based on the elaboration by Samuelson and Nordhaus, ***Economics,*** op. cit., pp. 412–13.
28. For data-based detailed discussion refer to Sudipto Mundle and M. Govinda Rao, ***Issues in Fiscal Policy*** in Bimal Jalan (ed.), ***The Indian Economy: Problems and Prospects,*** Penguin Books, N. Delhi, Revised Edition, 2004, pp. 258–85.
29. This was the general feeling among the experts, policymakers and the IMF, alike.
30. The proximate cause of the payment crisis in the mainstream perspective, was faulty macroeconomic policies, specially large fiscal deficits of the government during 1984–91, deficits that spilled over in country's current account of the balance of payment. (Mihir Rakshit, '***The Micro-economic Adjustment Programme: A Critique', Economic and Political Weekly 26,*** no. 34 (August), quoted by Mihir Rakshit, ***'Some Microeconomics of India's Reform Experience'*** in Kaushik Basu (ed.), ***India's Emerging Economy: Performance and Prospects in the 1990s and Beyond,*** Oxford University Press, N. Delhi, 2004, p. 84.
31. S. D. Tendulkar and T.A. Bavani, ***Understanding Reforms,*** Oxford University Press, N. Delhi, 2007, p. 73.

32. Bimal Jalan, ***India's Economic Policy,*** Penguin Books, N. Delhi, 1992, p. 48.
33. ***Handbook of Statistics on the Economy 2002–03,*** RBI, Table 221 (cited by ***Tendulkar*** and ***Bhavani,*** 2007, op. cit., p. 74)
34. Bimal Jalan, 1992, op. cit., p. 50
35. ***The Report of Tenth Finance Commission,*** N. Delhi, 1994 (*quoted by Bimal Jalan, 1992, op. cit., p. 50).*
36. This scheme has changed now. After the implementation of the suggestions of the ***12th Finance Commission*** states are now allowed to go for market borrowings to take care of their plan expenditures once they have passed and enacted their Fiscal Responsibility Acts (FRAs) in consonance with the FRBM Act, 2003.
37. Based on the points raised by Bimal Jalan, 1992, op. cit., p. 49.
38. This factor seems getting redressal with the starting of ***outcome*** and ***performance*** budgeting 2004–05 onwards.
39. ***Economic Survey 2006–07,*** MoF, GoI, N. Delhi, p.18.
40. *Ibid.*
41. *Ibid.*
42. ***Economic Survey 2003–04,*** MoF, GoI, N. Delhi.
43. ***Economic Survey 2006–07,*** op. cit., p. 18.
44. *Ibid.*
45. *Ibid.*
46. Opposite to it, in the U.K., the government has overriding powers on the central bank and there is absence of any legal checks on money creation powers of the government. Once the UK becomes part of the European Union it will come under such a check through the Maastricht Treaty. Before the enactment of the FRBMA, 2003. India was like the U.K, however, the Constitution of India has a provision for imposing a statutory limit on the centre's borrowing powers under ***Article 292.*** But the Article is not mandatory and has not been invoked by any of the governments till date.
47. By the Congress passing the Balanced Budget Act, 1997 which promised to eliminate federal deficit spending by 2002 (see *Nicholas Henry,* ***Public Administration and Public Policy,*** Prentice-Hall, N. Delhi, 8th Ed., 2003, p. 217).
48. Argentina introduced this arrangement in the late 1990s.
49. ***Economic Survey 1994–95,*** MoF, GoI, N. Delhi.
50. IMF imposed some macro-economic conditions on the economy while India borrowed from it for its BoP correction in 1990–91. One among the conditions was cutting down the government expenditure (i.e., salaries, pensions, interest and subsidies, etc.) by 10 per cent every year.
51. George R. Terry and Stephen G. Franklin, ***Principles of Management,*** AITBS, N. Delhi, 8th Ed., 2002, pp. 9–10.
52. See Peter A. Phyrr, ***The Zero Base Approach to Government Budgeting,*** Public Administration Review, 37 (Jan./Feb., 1977), p. 7 and Thomas P. Lauth, ***Zero-Base Budgeting in Georgia State Government: Myth and Reality,*** Public Administration Review, 38 (Sept./Oct., 1978) pp. 420–30 (cited in Nicholar Henry, ***Public Administration and Public Affairs,*** Prentice-Hall, N. Delhi, 8th Ed., 2003, p. 217).
53. Nicholas Henry, 2003, op. cit., p. 218.
54. In the Constitution of India it is deliberated in the ***Article 112 (3), a - g*** where it is referred as ***'expenditure charged'*** on the consolidated fund of India—popular as the 'charged expenditure' (see

    The Constitution of India, Ministry of Law, Justice and Company Affairs, GoI, N. Delhi, 1999, pp. 38–39).
55. See Samuelson and Nordhaus, ***Economics,*** op.cit., p. 710; Stiglitz and Walsh, ***Economics,*** op. cit., pp. 552–54.
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64. *Niall Ferguson,* "Conservatism and the Crisis: A Transatlantic Trilemma", Centre for Policy Studies, Ruttenberg Lecture, March 24, 2009.

65. ***Economic Survey 2011-12,*** op. cit., p. 69

66. The discussion is based on the releases of various **Ministries, Departments** and **Statutory** and **Non-statutory Bodies** of the **GoI**. The data used are soley taken from the latest **Economic Survey 2012-13** and the **Union Budget 2013-14** – any other data, if used, their sources have been given in brackets following them.

19

THE TECHNOLOGY-ENVIRONMENT DILEMMA

"Fundamentally, we have to revise our view of development versus the environment."
Jeffery Sachs, quoted by Nandan Nilekani

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- Holistic Thinking – Need of the Time
- Looking Ahead

* *Nandan Nilekani, 'Imagining India', Penguin Books, India, N. Delhi, 2009, p. 446.*

INTRODUCTION

We are passing through an era of 'technology vs environment' dilemma. Never before has so much attention been given to the issue of the ***'relationship between environment & technology'*** . While humanity continued realising higher growth and development on the 'vibes' of newer technologies; scholars remained busy debating the issues like – whether technologies are neutral, promote happiness or cause environmental degradation. We are at crossroads where shortcuts are available at every step, but there lacks an alternative technology which can promote its growth and developmental requirements and eventually doesn't threaten its habitat, surrounding, ecology and the environment. Global as well as individual attempts are in place but it is probably not possible to put a timeframe in which mankind will be able to solve the dilemma. This chapter is devoted to understanding this dilemma. All contemporary views of experts, together with the official stand of the major nations of the world, including India, have been included in the discussion.

TECHNOLOGY – THE TRADITIONAL VIEW

The old view about technological development was that they came into being through chance discoveries from the works of independent scientists and engineers. It was assumed that such discoveries are then applied if they increase industrial productivity, meet market demands and increase profits. In this way, inventions lead to innovations, innovations lead to the diffusion of technological products. In the history of technology, key points of interest have been, ***who the inventors were***, when they made their invention and on what scientific or technological advance the invention was based. Occasionally, attention is turned to why some inventions fail to make it as commercial technologies and what the barriers to that progression may be. Technology is therefore seen as merely the fruits of applied science.

By one view, technology is *neutral* and that is why techniques pursue no end in itself.[1] However, this view has been discredited by modern scholars who opine that the progress toward the wide adoption of a technology is neither smooth, nor inevitable. Many technologies were invented before the scientific principles on which they are based are known (steam engine is one example). Emerging technologies often compete. The choice of technologies as well as the way they are designed and developed are influenced by social as well as technical factors.

For *Economic determinists,* technologies are developed and selected to suit the prevailing economic conditions, for example, relative scarcity of land, labour, capital, and the products and services that are developed depend on market demand. The technologies which are a commercial success in the market are those that are widely adopted. However, economic determinism does not explain the development of technologies where there is no profit motive or market demand such as space research, military technology and even medical technology. Nor does it explain why the cheapest means of production is not always the one that is adopted.

More recently, the scholars of technological change tend to argue that the invention and engineering design process is guided and shaped by the goals of the designers and their *employers* or *clients*. This

is why, they argue that it is misleading to consider technologies as neutral or the inevitable result of progress . Basically, long before any technology is offered for use in the market, a process of selection occurs that is guided by social and political, as well as economic, considerations. This is why we have been seeing many report across the world in which the developers of a new technique or medicine have been blamed of concealing harmful effects. Recently, 'swine-flu' was almost declared to the proportion of a pandemic in which a 'WHO-drug manufacturer' connivance was highlighted.

TECHNOLOGY – AS MEANS OF RESOURCE USE

The reality of *environmental degradation* can be described as a product of population, resource use per person (affluence) and environmental damage per unit of resource used (technology). In the negotiation at the Earth Summit in Rio de Janeiro in June 1992, the USA wanted to remove all references to consumption (resource use per person) from the Agenda 21 document (the proposed plan of action for the 21st century). The US administration did not take suggestions that lifestyles would need to change in affluent nations, and the then US President, George Bush said, 'The American lifestyle is not negotiable'.[2] Two main reactions came to this –

i. *Developing* and *low-income nations* retaliated by removing references to the urgent need to slow population growth. These nations ultimately wanted to shift responsibility for environmental problems onto industrialised nations.
ii. The *Women's groups* from the USA and low-income nations supported these moves, arguing that population control 'jeopardises women's health, is disguised genocide, or places blame on women' rather than on the economic systems that exploit and misuse nature and people.[2]

The absence of a consensus on either of the two issues; ***population*** and ***consumption;*** and the political need for the concept of sustainable development to accommodate economic growth, means that the achievement towards sustainable development will depend on our ability to reduce the environmental impact of resource use through technological change. Many interest groups accept this political reality. They see continual growth in a ***finite world*** as possible, through the powers of technology, which will always be there to help us find new sources or provide alternatives if a particular resource appears to be running out. Otherwise, technology will help us to use and reuse what is left in the most efficient manner.

The legislative measures, economic instruments and consumer pressures are aimed at achieving technological changes such as recycling, waste minimisation, substitution of materials, changed production processes, pollution control and more efficient usage of resources. *The Commission for the Future*[3] says 'the challenge of sustainable development is to find new products, processes, and technologies which are environmentally friendly while they deliver the things we want'. This view is generally held across the spectrum of political views as per which: an ecologically sustainable society 'will require large amounts of new technology, technological innovation, modern management practices' as well as changes to lifestyle.[4] Same group of experts believe that environmental damage can be reversed with modern technology, and that new technologies can rectify the problems caused by older technologies.[5] The *Pearce Report* also suggests that resource usage can be dealt with

through recycling and minimising wastage, and that the use of the environment for disposing of wastes can be minimised in a similar way : 'Recycling, product redesign, conservation and low-waste technology can interrupt the flow of wastes to these resources, and that is perhaps the major feature of a sustainable development path of economic progress.'[6]

Still some questions remain to be addressed. What sort of changes are necessary to precipitate dramatic technological changes? Will technology alone be enough to solve the environmental problems facing us? Should there be no change in our consumption style?

TECHNOLOGY – AS THE CULPRIT OF ENVIRONMENTAL PROBLEMS

We can take some clues from the first lot of insightful writings by the scholars of the past. One among them was the Harvard educated US biologist Barry Commoner. His writings (supported by empirical data) are considered to belong to the first lot of such views which left deep impact on the scholars and the policymakers of the time, across the world. Barry Commoner, [7] in early seventies, argued that the escalating growth of environmental problems in the USA was due to flawed technology, rather than population growth or affluence. He pointed out that pollution was increasing at a much faster rate than population or economic growth. The difference, he argued, could be accounted for by the emergence of new technologies after World War II. He noted that in the twenty-five years following the war, the production of non-reusable soft-drink bottles had increased by 53000 per cent, synthetic fibres by 5980 per cent, and mercury used for chlorine production by 3930 per cent. During that same period, the production of food, textiles, clothes and metals had only increased at similar rates to population growth (42 per cent); and cotton fibre, wool and soap manufacture had decreased.[*]

These were the reasons why he argued that it was not economic growth itself that created environmental problems but how it was achieved. The new production technologies had a far greater environmental impact than the ones they replaced. As *an example*, Commoner looked at farm technologies. He pointed out that the traditional *fertilising system* of farms, where animals provided the manure for fertilising the land, had been interfered with by the use of feedlots, where animals were confined in small areas whilst being fattened up for market rather than leaving them grazing on pastures. The resulting heavy concentration of manure placed undue strain on a small area of land which could not naturally deal with so much waste. The waste, therefore, tended to pollute underground and nearby waterways. Animals in feedlots were fed on grain, and the land used to grow the grain was depleted of nutrients; so that farmers had to resort to artificial fertilisers, especially nitrogen, that created their own pollution problems because some of the chemicals used ended up in the waterways.

Similarly, the use of *pesticides* also enabled farmers to get higher yields from smaller land areas, but at an environmental cost. Pesticides such as DDT also polluted waterways, and killed or harmed other insects and animals (and sometimes humans) that were not originally targeted. While artificial fertilisers depleted the soil of naturally occurring nitrogen-fixing bacteria, pesticides killed off the pests' natural predators, and the pests themselves built up resistance to the pesticides. This ensured continuing dependence on the new chemicals and the need for ever-increasing amounts to be used.

In a*nother example* Commoner talked about the replacement of soaps by detergents. He estimated that the production of the active agent of detergents required three times as much energy as soap. The burning of fuel and high- temperature reactions needed during manufacture of detergents added to air pollution. Not only did the manufacture of detergent subject the environment to greater stress than soap, but its disposal created a whole new set of problems. The original detergents did not biodegrade in the environment, and they created mountains of foam in waterways. The new generation of detergents developed to solve this problem did not produce foam but were more toxic to the fish in the waterways. Also, the phosphate in the detergents stimulated algal growth which could choke rivers or stress them with an overload of organic material. Detergents replaced soaps on the markets, argued Commoner, not because they were better at cleaning but because of the advertising efforts of detergent manufacturers.

He provides a *third example* which deals with *textile production*. Synthetic fibres, which are often derived from non-renewable resources such as oil or natural gas, have replaced natural fibres such as cotton and wool in many applications. They require extremely high temperatures to manufacture, which adds to air pollution and energy usage. Furthermore, unlike the natural fibres, they do not break down in the environment. The manufacture of synthetic fibres, plastics and detergents has required big increases in the production of organic chemicals. Since mercury was used to manufacture organic chemicals, this meant the load of mercury in the environment increased.

He concluded that the new technologies also used more electric power and other forms of energy than those they replaced. During the time he was writing the book, aluminium and chemical production alone accounted for 28 per cent of US industrial electricity use. This, in itself, meant more use of energy resources and more pollution.

Precisely, the experts today conclude that though technologies seemed to be solving the immediate problems of humanity's urge for higher growth and development, they were basically, adding problems for the future in a hidden way. It means, every technology had a hidden cost to it. Mankind went on excluding those costs intentionally or unintetionally – a clear case of 'flawed accounting and thinking about the risk'.[8] Those hidden costs were just waiting there to become visible. They are now taking toll in the forms of 'disturbed weather conditions', 'melting ice-shields', 'submerging islands' and finally, culminating into the greater danger of 'climate change'.

THE POSSIBLE ALTERNATIVE

The idea of an 'appropriate technology', which could provide sustainability to our planet and at the same time does not hinder the growth of humanity either, has always been a hot topic of debate, epecially, in the western world. The first idea of 'Appropriate Technology' was formulated by the British economist, E.F. Schumacher, which today exists in many different forms and flavors.[9] The experts defined it precisely this way – *appropriate technologies are those systems of technology which promote and maintain a sustainable culture*. The modern industrial culture of North America, Europe and other industrialised nations is hardly sustainable, and the technologies employed here exhibit dubious appropriateness.[10] It has been recognised that developing appropriate technology requires changes in the socio-political and cultural mind set.[11] We do not see these conditions

available in the western developed world till recent times, as they have been the harbingers of technology diffusion to rest of the world. But in recent times, the attitude is changing. Since early 1970s experts have been debating everything from 'neutrality' of technology to the 'sustainable culture' and 'sustainable technologies' much of which is today known as the primers in 'environmentalism'. But at least the experts were able to sensitise the issue of sustainabilty and made the world think about in the coming decades in a more concerned way, and finally, we see the idea of 'sustainable development' being mooted out by the world in 1987.[12]

With societies coming to terms with the environmental implications of its economic and industrial practices, the role of technology is being increasingly scrutinised. The emergence of modern socio-technical systems marked a new phase in human creativity and scientific accomplishment, but has simultaneously resulted in the disruption of ecosystems from the local to the global level. A fundamental reorientation of both the principles of technology development and the institutional arrangements that govern the delivery of goods and services is required, in order to meet the needs of a rapidly expanding human population.

While some observers believe that technology can be harnessed and directed in ways that minimise degradation of ecosystems, it is often difficult to determine what constitutes an **'environmentally sound'** technology. While the explicit consideration of environmental objectives and constraints in product and process development can lead to ***'green'*** technology solutions, in reality, *the question of what is green depends on how environmental problems are defined.* As problem definitions change, solutions also change. The scholars and experts have disccussed, through time, **three alternative ideas** which highlight the different roles that technology can play with respect to the environment –

1. Environmental Protection
2. Resource Management
3. Eco-Development

These alternative ideas suggest different criteria for defining green technologies. In each case, technological innovation will likely have the least impact on the environment if it is used to address problems in a holistic or systems fashion. The course of technical and industrial advancement over the last century has fundamentally transformed the relationship between human society and the natural world. As the scope and range of human activities have expanded exponentially, profound and possibly irreversible environmental changes have been set in motion.[13] For the first time in history, mankind can potentially alter the basic biophysical cycles of the earth.

The social systems which we are living in, have clearly broken away from the patterns of ecological stability that existed for almost the 2 million years when humans lived in small nomadic bands.[14] Undoubtedly, there is no turning back. While some believe that, our capacity for technical and economic progress is virtually boundless, the fact that human activities are now resulting in massive disruptions in nature is a reality. Release of elements such as mercury, nickel, arsenic, and vanadium are now several times those by natural processes. For lead, the amount released is nearly 300 times than the leed that is released by the natural processes.[15] Concentrations of carbon dioxide in the atmosphere are increasing at a rate 30 to 100 times faster than observed in the climatic record; methane concentrations are increasing 400 times faster than historically seen.[16]

Faced with the emerging environmental implications of its economic and industrial practices,

societies across the world are scrutinising the role of technology in a more concerned way. We are, at times, asking some highly logical questions to ourselves , such as

- Is technology simply a vehicle for satisfying a growing list of human wants?
- Is technical innovation being deployed regardless of its ecological impacts?
- Is it efnough to develop new environmentally sensitive technologies under current economic incentives, or does there need to be a shift in the fundamental assumptions underpinning economic behavior (for example, do we really want products or simply the services that products provide)?
- Can technology be used as a means for reducing rates of consumption while still providing for people's needs?
- Can we fulfill our obligations to future generations by simply substituting technological capital for rapidly disappearing natural capital?

To the extent the major **tribal societies** of the world are concerned they have been always critical to the new tools and techniques of promoting growth and development. But their views were generally considered as the opinions of uneducated and 'savage minds'.[17] Right from Australian Aborigines to the Bhils and Santhals of India, almost all of them, objected even to the construction of metallised roads running through their habitat 'modern factories and the townships'. Today we see the same people getting support from the non-tribal population against the proposals of the *Poscos* and *Vedantas* in India. Just the colours of the people's movement have changed but the basic question remain the same – Will the local habitat and the ecosystem sustain the fallouts of these developments? The government is innovating a new idea to fight such agitations by proposing a share for the 'local community' in the profit of the industrial units to be set up there! Will it make the industrial practices 'ecologically sustainable'? We don't have the answers, again!

The above-given questions are not easy to answer. However, it is clear, that the value structures and ethical frameworks of modernity will determine whether technological innovation is used for the protection or destruction of natural ecosystems. Technology has at once been the source of many environmental problems, but also a means for safeguarding environmental quality.[18] The emergence of concepts such as *'green engineering'* or *'green design'*, reflects the underlying confidence of many observers that technology can be harnessed and directed in ways that minimise disruption of the environment.[19]

While the explicit consideration of environmental objectives and constraints in product and process development can lead to 'green' technology solutions, in reality, the question of what is green depends on how environmental problems are defined. As problem definitions change, solutions also change. Basically, one's philosophical view of the relationship between human activity and the environment strongly conditions one's understanding of the role of technology and the 'environmental problems' that technology can potentially address. For better understanding of the issue and the possible wayouts we may discuss the ***three alternative ideas*** that highlight the different roles that technology can play with respect to the environment.[20]

Environmental Protection

In this idea, the environment is recognised as an *economic externality*[21] that must be safeguarded

through laws and regulations. Tradeoffs are seen between industrial competitiveness and protecting the environment – such as employment vs. protecting endangered species – and cost-benefit analysis is offered as a means of balancing the two. This view is fundamentally anthropocentric (which means humans as more important than anything else), with the principal concern being the effect of pollution on human health and welfare.

In this case, the 'problem' is that human society produces too much waste. This is why this idea leads to policies that focus on reducing the quantity or toxicity of waste, e.g., waste prevention, recycling, or waste treatment. Consequently, technology should be used to reduce the quantity and toxicity of wastes requiring disposal, for example, making products more recyclable, light-weighting, eliminating hazardous materials, etc. Progress is measured in terms of increasing efficiency of energy and materials use; that is, reducing the quantity of energy and materials required per unit of production. This view does not concern itself explicitly with whether the physical flows of energy and materials through the economy are 'ecologically sustainable'.

If we take examples from India, many times, media reports non-compliance by the industries to the causes of waste disposal, recycling, etc. In this case, domestic and multinationals have been behaving in similar fashion, and the plants set up by the industrial units are not functional. Naturally, a more aware society and a state of 'good governance' can make a great help here..

Resource Management

In this idea, the environment is recognised as an *economic externality* that must be internalised in measures of economic performance and policy decision making. The view sees earth as a *closed economic system*, and therefore the main challenge is to 'economise ecology'. If those who use resources and generate pollution are made to pay the true price of those environmental services, this will lead to sustainable industrial development. Advancing technology is seen as an integral part of achieving more efficient use of energy and materials. Technologically, advanced countries should aggressively transfer new and more efficient technology to developing countries, and assist them in stabilising their populations.

In this idea, the 'problem' is that human society is managing its resources poorly, generating pollution that threatens to undermine the ecological productivity upon which the economy depends. The solution is to 'get the prices right' through taxes on resource use and pollution, or perhaps tradable permits to pollute within sustainable limits. Such economic incentives are seen as providing more flexibility than regulations, so that industry can respond in the most cost-effective way. Imposing 'environmental taxes', 'carbon credit' and the idea of the GEF (Green Energy Fund) fall under this category to name the major ones. The whole global idea of climate change today revolves around the issue of 'funding' the technology and practices required to check the ensuing danger of climate change (with the **Doha-2012** being no exception).

This view assumes that environmental services can be monetised, and that functioning markets for these services can be created. It does not address uncertainties in the valuation of these services or in the correct determination of the relevant ecological thresholds or global carrying capacities. It is primarily anthropocentric, since it is concerned with the stock of "resources" available for human use, but extends its concern to quality of life of future generations as well as the present generation. Sustainable development is defined as maintaining a nondecreasing stock of human plus natural

capital, implying some substitutability between the two.[22]

In this view, technology development would involve choices that conserve resources as well as reduce wastes. Emphasis would be on the materials inputs in products, e.g., avoiding the use of materials that are toxic or become dispersed in the environment. In principle, the prices of material inputs would reflect their demand on environmental services, thus providing the correct signals to technologists and designers. The resulting price changes would cause reorganisation of the production system toward *cleaner technologies* and discarded materials would have a higher value, thus encouraging recovery and recycling.

We see a major policy shift recently announced by the USA guided by this view. President Barak Obama gave a call for searching an alternative energy source to the 'petro fuels'. Though world sees this policy shift guided by many different things also. A three time Pulitzer Prize winner advised the US politicos to go and search for a 'clean energy' and 'clean power'[23] to bring back the past glory of the USA , signalling such development as the greatest opportunity of our time.

Analysts see this shift in the US thinking a watermark in the process of restructuring the world view of the nations of the world, as it will provide the US economy a space to think outside the 'Gulf region'. We see similar steps being taken by other nations also. Recently, the European Union announced a major policy of setting up hydrogen fuel stations so that 'fuel cell' can be used in a commercial way. And by the mid-March 2013, the South Korean automobile major Hyundai announced the launch of its 'hydrogen-driven' (fuel cell based) car to go for commercial sale across Europe in 2014. By early February 2013, the Indian, Prime Minister gave a similar call to the automobile industry to replace 30 per cent of all automobiles by 'electric engines'. Soon by mid-March 2013, the India automobile company, Mahindra & Mahindra lauched its electric car in Delhi with heavy discounts given by the Delhi government in Road Tax and the VAT.

Eco-Development

The eco-development view stresses the co-evolution of human society and ecosystems on an equal basis. The earth is seen as a *closed ecological system* and therefore the principle challenge is to **'ecologize the economy'**. This view is less anthropocentric than the resource management view, emphasising that nature has an intrinsic value that is independent of the value placed upon it by the human economy. Thus, this view has a moral or *ethical dimension* that implies a transformation of societal attitudes toward nature. This dimension was not assumed in the previous ideas. The 'problem' in this case is that the scale of human economic growth is inconsistent with the long-term co-existence of humankind with nature. Sustainability is defined as non-decreasing stocks of human and natural capital maintained independently which means no substitutability between technology and natural resources.[24] In the face of uncertainty about ecological thresholds and the world's carrying capacity, the 'precautionary principle' implies that new technologies or development projects must demonstrate that they are consistent with sustainability as defined above, before they are adopted. Progress is measured not in terms of efficiency, but in terms of the health of regional ecosystems as well as human health.[25]

Policy objectives under this view would include moving toward a ***closed materials cycle***. The economy would rely principally on *renewable sources* of energy and materials, extracted at rates that

would not affect ecological health. The non-renewable resources would be recovered and recycled indefinitely. Instead of tradable pollution permits, tradable permits might be issued for the extraction of a fixed quantity of non-renewable materials. The production/consumption system would be restructured to optimise the utilisation of goods to satisfy essential human needs, rather than the ownership of goods to satisfy *'frivolous wants'*. Green products and technologies would avoid the use of materials that are toxic to humans or ecological systems, substitute renewable for nonrenewable materials, and ensure that nonrenewable materials could be readily recovered for recycling.

IMPLICATIONS OF THE IDEAS

These three ideas illustrate the different assumptions that underlie the **environmental policy debate** of our times, across the world. They reflect different views towards humanity in the natural world, and of its obligations to future generations as well as other species.

Present U.S. policy is most closely approximated by the environmental protection paradigm, while many environmental groups espouse the eco-development perspective. Resource management is viewed by many policymakers as the most practical approach toward reconciling economic activity and environmental quality.

These ideas also suggest different criteria for defining green technologies. In the environmental protection view, a specific technology or product design may be considered green if it results in less waste generation than a previous technology. The same design may be rejected from the eco-development perspective because it uses non-renewable materials that are not recycled and do not biodegrade.

Thus, green technology development within each succeeding 'views' involves satisfying a correspondingly broader set of criteria for compatibility with the natural environment.[26]

HOLISTIC THINKING – NEED OF THE TIME

Whatever be the 'idea' adopted by society, technological innovation will likely have the greatest environmental benefit if it is used to address problems in a holistic manner. From an environmental perspective, it is simplistic to view technologies or products in isolation from the production and consumption systems in which they function. Bigger environmental gains lie in changing the overall systems in which technologies or products are manufactured, used, and disposed, rather than in modifying technological components or changing the composition of products itself.

Technological solutions are usually context dependent, for example, 'reformulated' gasoline could be considered to be 'greener' than current gasoline formulations, since it reduces emission levels of various pollutants. However, a 'zero' emissions vehicle such as an electric or a hydrogen car represent an even greener solution. Promoting mass transit could be regarded as environmentally preferable alternative to electric vehicles, and the environmental impacts associated with mass transit could perhaps be reduced by placing a greater reliance on telecommunications. It means, there are

different levels of solutions possible, with each succeeding solution having a higher degree of organizational complexity, and a more formidable set of institutional and economic obstacles. Here, the most environmentally desirable solution involves changing transportation systems rather than specific technological components (for example going for a more efficient internal combustion engine).

A true holistic view implies a unified consideration of production and consumption activities. The supply side and demand side requirements need to be treated in an integrated way. This implies a new way of looking at products, as well as new patterns of industrial organisation. The opportunities for linking technology development and product design with holistic thinking have not been fully explored, but examples are beginning to appear in different sectors of the economy. For instance, pesticide use has declined dramatically where farmers have adopted *integrated pest management* (IPM) schemes involving crop rotation, and the use of natural predators.[27] Such cases have been cited in India also by the recent studies of the farmers' practices. Due to the success of these new methods, chemical companies are no longer simply supplying pesticides to farmers, but are also providing expertise on how to use those chemicals in conjunction with better field design and crop management. Thus, we see services/ knowledge substituting the chemicals.

In the energy supply sector, similarly, many utilities are providing *energy audit* services, and are promoting customer use of energy-efficient equipment, instead of constructing new generating plants. After all, energy is not used for its own sake, but rather for the services it provides, such as heating, lighting, and transportation.[28]

The idea of integrated pest management in the chemical sector, and demand-side management in the utility industry, can be applied in a more general way to other industries, too. When a technology or product is viewed as an agency for providing a service or fulfilling a specific need, the profit incentive changes; income is generated by 'optimising the utilisation of goods rather than the production of goods'.[29] The notion of thinking about a product in terms of the function it performs, is a logical extension of total quality management philosophy. The aim of total quality management is to satisfy *customer needs*. Customers usually don't care how their needs are met, as long as they are indeed met. Therefore, it should not matter whether a customer's requirements are satisfied by a specific product, or by a service performed in lieu of that product. Holistic thinking therefore offers the possibility of reducing resource consumption rates while still meeting the needs of consumers.[30]

LOOKING AHEAD

Given the complexity of the environmental problems we are facing, it is unlikely that we will be able to discern the long term implications of the decisions we make now. This is particularly true of our technological decisions. For example, there was never a clearly articulated societal goal to become reliant on fossil fuels; this reliance came about because petroleum was able to satisfy specific technical and economic constraints that emerged at particular points in time. In light of the environmental and national security concerns associated with fossil fuel dependence, this choice of a primary energy source now seems to have been less than optimal. This example seems to follow a more general pattern of technology evolution. Recent work provides intriguing evidence that once a

particular technology path is chosen, the choice may become 'locked in', regardless of the advantages of the alternatives.[31]

All technological trajectories are shaped by a variety of economic, social, and political forces. They usually cannot be changed without encountering opposition from well entrenched interests (which try to maintain status quo). Sorting out these conflicting interests requires the articulation of broad social goals set by the political leaders, and historically has been achieved only in times of crisis. Thus, harnessing and channeling technology in productive and ecologically sound ways will no doubt prove to be a formidable undertaking given the inertia of our political and economic systems. Much will depend upon the decision-makers, the world political elites as how they make present generation to visualise their present in reflex to the future. Let us hope and wait for a better tomorrow!

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9. Kelvin Willoughby, ***'Technology Choice: A Critique of the Appropriate Technology Movement',*** Westview Press, Boulder, UK, London, 1990, p. 15.
10. Richard L. Meier, ***'Prerequisites for Sustainable Communities',*** In Listserv Item No. 82, March 3, 1994.
11. N. Jequirez, ***'Appropriate Technology: Some Criteria',*** Towards Global Action for Appropriate Technology, edited by A.S. Bhalla, Pergamon Press, New York, 1979.
12. We may cite some of the news-making works of the time:
    i) Donella H. Meadows, Dennis L. Meadows, Randers, Jorgen & Behrens, William W. III, 'The Limits to Growth, A Report for the Club of Rome's Project on the Predicament of Mankind', Pan, London and Sydney, 1972.
    ii) Paul Hofseth, 'Ecology and Appropriate Technology', in ***Mobilizing Appropriate Technology,*** edited by Matthew S. Gamser, IT Publications, London, 1988.
    iii) Richard L. Meier, 'Prerequisites for Sustainable Communities', In listserv, Item 82, Jan. 3, 1994.
    iv) Herman E. Daly & John B. Cobb Jr, ***For the Common Good: Redirecting the Economy toward Community, the Environment, and a Sustainable Future,*** Beacon Press, Boston, 1989.
    iv) Jerry Mander, ***'In the Absence of the Sacred: The Failure of Technology and the Survival of the Indian Nations',*** Sierra Club Books, San Francisco, 1991.)
    v) Roberto Vacca, ***'Modest Technologies for a Complicated World',*** Pergamon Press, New York, 1980.
13. The world economy is consuming resources and generating wastes at unprecedented rates. In the past 100 years, the world's industrial production increased more than 50-fold. See W.W. Rostow, 'The World Economy: History and Prospects', University of Texas Press, Teaxas, 1978, pp. 48-49.

14. Clive Ponting, 'Historical Perspectives on Sustainable Development', Environment, Vol. 32, No. 9, November 1990.
15. James Galloway, et al. Atmospheric Environment 16 (7): 1678, 1982. Also see Robert U. Ayres, ***'Toxic Heavy Metals: Materials Cycle Optimization',*** Proceedings of the National Academy of Sciences, vol. 89, No. 3, Feb. 1, 1992, pp. 815-820.
16. U.S. Congress, Office of Technology Assessment, ***Changing By Degrees: Steps to Reduce Greenhouse Gases,*** OTA-O-482, U.S. Government Printing Office, Washington, DC, February 1991.
17. Claude de Levi-Strauss, 'The Savage Mind', Black Swan, Paris, 1985. The 'savage mind' has been used by him to prove the 'uncivility' of not only the tribal people but a large segment of the developing societies of today's times. The French philosopher is also credited to develop the idea of 'structuralism'.
18. For example, advances in agricultural science have greatly improved food production around the world, but at the same time the use of pesticides, an integral part of modern agricultural methods, have led to a number of environmental and human health problems. On the other hand, new pollution control technologies have greatly reduced environmental emissions, while new manufacturing technologies have improved materials and energy efficiency. From 1972 to 1985, for instance, the Gross Domestic Product (GDP) of the United States grew by about 40 percent, but energy consumption remained basically flat. Nearly two-thirds of this decline in energy consumption was due to the introduction of energy efficient technologies; the remaining third was due to structural shifts in the composition of the economy (i.e., a shift away from heavy manufacturing towards services). See U.S. Congress, Office of Technology Assessment, ***Energy Use and the U.S. Economy,*** OTA-BP-E-57, U.S. Government Printing Office, Washington, DC, June 1990.
19. See U.S. Congress, Office of Technology Assessment, ***'Green Products By Design: Choices for a Cleaner Environment',*** OTA-E-541 (Washington, DC: U.S. Government Printing Office, October 1992).
20. The discussion here is based on the taxonomy developed by Colby. A set of five paradigms, ranging from 'frontier economics' to 'deep ecology' is used describe the relationship between economic development and the environment. One extreme, frontier economics, focuses on economic growth and emphasises free markets and unbridled exploitation of resources. The other extreme, deep ecology, focuses on harmony with nature and emphasises drastic reductions in human population and the scale of human economies. Here we describe the technology implications of the three middle paradigms. See Michael E. Colby, ***'Environmental Management in Development,'*** World Bank Discussion Papers 80, Washington D.C., 1990.
21. Economists use the term 'externality' to refer to spillover effects that are not accounted for by the marketplace. For example, air or water pollutants that are by products of an industrial process are environmental externalities. Firms do not have the incentive to reduce or eliminate such pollutants unless economic penalites such as emissions taxes are applied, or unless the firms are required to do so by regulation. See William D. Nordhaus, ***"The Ecology of Markets,"*** Proc. Natl. Acad. Sci. USA, Vol. 89, pp. 843-850, February 1992.
22. Human capital in this sense refers to 'knowledge' or technological capital. This notion of substitutability has been called the criterion of 'weak sustainability'. See Herman E. Daly and John B. Cobb, ***For the Common Good: Redirecting the Economy Toward Community, the Environment, and a Sustainable Future,*** Beacon Press, USA, Boston, 1989.
23. Thomas L Friedman, Hot, Flat, and Crowded, Penguin Books, Great Britain, London, 2009.
24. This has been called the criterion of ***'strong sustainability',*** Daly & Cobb, op. cit.
25. Even though advanced industrial societies are becoming increasingly efficient in their use of materials, a phenomenon known as ***"demate- rialisation,"*** in the eyes of some, greater industrial efficiency by itself is not a sufficient response to environmental problems. Indeed the absolute quantities of materials consumed and wastes produced are increasing; they are just not increasing as fast as GNP.
26. Moreover, within each idea, technologists will likely be confronted with a variety of difficult tradeoffs. For instance, there are typically many environmental tradeoffs associated with the use of a specific material. As an illustration, the new class of high temperature superconductors, which potentially offer vast improvement in power transmission efficiency and have other promising applications, are quite toxic; the best of the superconductors is based on thallium, a highly toxic heavy metal. The fact that products that use toxic materials can perform socially useful functions, or even have comparative environmental benefits, underscores the need for a flexible approach to environmental questions. For additional discussion of this issue see 'Green Products By Design', op. cit., footnote 6.
27. See U.S. Congress, Office of Technology Assessment, ***Beneath the Bottom Line: Agricultural Approaches To Reduce Agrichemical Contamination of Groundwater,*** OTA-F-418 (Washington, DC: U.S. Government Printing Office, November 1990).
28. But to encourage decision making on a system-wide basis, utilities need to be allowed to benefit financially from investments in efficient end-use equipment. Recent changes in regulatory frameworks have played a key role in moving utilities in this direction. See U.S. Congress, Office of Technology Assessment, ***Energy Technology Choices: Shaping Our Future,*** OTA-E-493, (Washington, DC: U.S. Government Printing Office, July 1991).

29. Walter Stahel, The Product-Life Institute, Geneva, Switzerland; Personal Communication. For more on this idea see Orio Giarini and Walter Stahel,***"The Limits to Certainty: Facing Risks in the New Service Economy,"*** (Boston, MA: Kluwer Academic Publishers, 1989).

30. In an ultimate sense, a true systems philosophy involves consideration of many different perspectives, and not simply an economic or technological perspective. Humanity is now confronted with a series of global problems such as rapid growth and migration of populations, crushing poverty, intractable religious and ethnic conflicts, and widescale ecological damage – that in one way or another are linked together. "None of these problems can be fully addressed without considering all the others." See ***"The Most Vital Challenge,"*** Statement by the Baha'i International Community at the Plenary Session of The United Nations Conference on Environment and Development, Rio de Janiero, June 4, 1992.

31. W. Brian Arthur, ***"Positive Feedbacks in the Economy,"*** Scientific American, February 1990.

20

SUSTAINABILITY AND CLIMATE CHANGE: INDIA AND THE WORLD

".......this is the only home we have and, as environmentalists are fond of saying, Mother Nature doesn't do bailouts........So we better find a better way to grow."

*Thomas L. Friedman **

- Introduction
- International Collaboration and Efforts
- Discussions under G 20
- Financing Climate Change
- Problems & Prospects
- Epilogue

*** Thomas L. Friedman, 'Hot, Flat, & Crowded', Penguin Books, London, 2009, p. 23*

INTRODUCTION

Improving living standards for mankind has been the single minded goal of all nations and world bodies. After defining development in numerous ways for over two decades, there seems to be a consensus on 'Human Development'. While a large popnlation on the earth is still to get the 'bare minimum' for development, humanity is at the crossroads where it is faced with the first of its kind challenge – the challenge of 'climate change'. The dilemma is that whatever we can do for our development, there has to be a repercussion on nature. An even bigger dilemma is in achieving a global consensus on how to check or restrict and finally reverse the process of climate change.

We may consider the year 2012, arguably, a high water mark in the field of environment and sustainable development initiatives. The global community met at the *UN Conference on Sustainable Development* that took place in **Rio** in June 2012, also marking the 20th anniversary of the first Earth Summit held in 1992. The Conference reviewed the progress made, identified implementation gaps, and assessed new and emerging challenges, which resulted in a political outcome called the *'The Future We Want'* . In India, the Twelfth Five Year Plan was launched with a focus on sustainable growth. This along with sustainable development policies and programmes which are being followed signalled to citizens at home and the world at large that India is committed to sustainable development with equal emphasis on its three dimensions - social, economic, and environmental.

A survey of the global comparative opinion shows that people in India and indeed all countries, have a marked and rising concern about sustainable development and climate change *(cited by the Economic Survey 2012-13)*. However, the challenges are also formidable, especially in the context of finding the matching resources of the required magnitude given the economic conditions. Climate science has rightly taken up an important position in the public debate. Even as the science of climate change grapples with uncertainties, the world is witnessing more extreme events. The urgency for action is felt more than ever before. In contrast, though the Doha, Gateway on climate change in December 2012 agreed upon a multilateral and rule-based regime to reduce emissions, the emission pledges on the table by the developed countries lacked ambition. Now the Fifth Assessment Report of the Inter-governmental Panel on Climate Change (IPCC) is in the final stages of completion. With rising extreme events, and rising citizen demand, the world has little option but to listen to the voice of evolving science and respond adequately with strategies and policy rooted in the principles of multilateralism with equitable and fair burden sharing.[1]

The *Economic Survey 2011-12,* for the first time, introduced a new chapter the 'Sustainable Development and Climate Change'. These topics remained headline news with extreme weather events both at home and abroad. Efforts to arrive at a consensus on what to do at home and abroad gathered momentum, even as they sailed through some rough waters and fickle seas in many respects. In 2012, science and nature voiced a sense of urgency for action. Yet the relevant statistics have a mixed story to tell. It strongly accepts science but weakly reflects on the corresponding multilateral actions, suggesting that a lot remains to be done on the latter. Till the world stops to introspects and accepts that we are a product of the ecological surrounding we are living in, there seems no durable outcome from the international deliberations.

Climate Change at a Glance

Since the industrial revolution, manmade activities have added significant quantities of greenhouse gases (GHG)[2] into the atmosphere. Climate change is a global negative externality primarily caused by the building up of GHG emissions in the atmosphere. The efforts needed to address the climate change include mitigation of GHG emissions on the one hand, and building of adaptive capacities to cope with the adverse impacts of climate change on the other. From a developing country perspective, adaptation is of utmost importance as they are the ones who are most vulnerable to the adverse impacts of climate change.

The incremental impact of a ton of GHG on climate change is independent of where in the world it is emitted. These emissions impose a cost on both the present and future generations, which are not fully recouped from the emitters of these emissions. This formed the starting point for a globally coordinated policy action and the need for an international climate change negotiating regime. UNFCCC, set up in 1992, although global in scope, differentiates the commitments/responsibilities of Parties on the basis of historic responsibilities, economic structures, and on the basis of the principle of 'equity' and CBDR which is at the core of the climate change debate.

The largest share of historical and current global emissions of GHGs has originated in developed countries. Scientists attribute the global problem of climate change not to the current of GHG emissions but to the stock of historical GHG emissions. Most of the countries, particularly the industrialised countries, having large current emissions are also the largest historic emitters and the principal contributors to climate change. The Convention therefore lays down legally binding commitments for the developed countries, taking into account their historical responsibilities and also squarely puts the responsibilities on developed countries for providing financial resources, including for the transfer of technology, needed by the developing countries. The Convention also acknowledges that climate change actions taken by developing countries are contingent on the resources made available to them.

A volatile mix of erratic weather, natural disasters, and enormous pressure on the availability of clean air, water, and energy together with the problems of poverty and hunger continues to be of great concern for policymakers particularly in the developing countries. There was building of the forward momentum both globally and domestically with three high-profile events in the global arena in 2012 and launch of the Twelfth Five Year Plan at home. The Earth Summit in Rio also popularly known as Rio + 20 celebrated its 20th anniversary, next the 11th session of the Conference of Parties (**COP 11**) to the Convention on Bio Diversity (CBD), hosted by India in Hyderabad, and finally the year closed with the 18th session of the COP to the United Nations Framework Convention on Climate Change (UNFCCC) in **Doha** in December. These international collaborations came out with balanced packages though short on ambition but proceeding on efforts. At home, we launched the Twelfth Five Year Plan whose explicit theme was a 'faster, more inclusive and sustainable growth' process. It is the first time that a five year plan has sustainability as a prominent focus. The Twelfth Plan outlined lower carbon growth strategies adding momentum to the ongoing policies and programmes of the government on environment and climate change. To add to this, State Action Plans on Climate Change (SAPCC), a recent initiative, will tune national initiatives on the National Action Plan on Climate

Change (NAPCC) to regional, socio- economic and ecological conditions. The SAPCC is expected to take off as part of the plan scheme for states. With these developments, it is clear that sustainable development and climate change issues are being addressed on a priority basis.

The world population crossed the 7 billion mark but with continued decline in population growth rates. Urbanisation continues to grow with more demand for resources. A United Nations Environment Programme (UNEP) study, ***'Keeping Track of Our Changing Environment: From Rio to Rio + 20 (1992- 2012)'***, tells the story of where the world collectively stands today on the sustainability and environment front. According to this study, both global gross domestic product (GDP) and the human development index (HDI increased by 2.5 per cent per year) continue to increase but variation and inequalities between regions still exist. The study also points to the growing pressure on agriculture, water, fisheries, and land resources. Pressure on natural resources reflected in per capita global use of natural resource materials has increased around 27 per cent between 1992 and 2005 though there has been a decline in emissions and energy and material use per unit of output, indicating improvement in efficiency levels. At the same time, global greenhouse gas (GHG) emissions have continuously been rising. GHG emissions measured in $\mathbf{MtCO_2\ e}$ (million metric tons of CO_2 equivalent) from 1990 to 2005 register an increase of 25.9 per cent *(World Resources Institute).*

Positive and rising trends in global efforts are competing against mixed trends.In 2011, global investment in the renewable energy sector, went up 17 per cent to $257 billion hitting another record. In terms of new capacity added in 2011, renewable power (excluding large hydro Electrical project) accounted for 44 per cent of the total new generation capacity added worldwide; up from 34 per cent in 2010 (Frankfurt School of Finance and Management 'Global Trends in Renewable Energy investment 2012').The global community is now working upon a set of Sustainable Development Goals (SDGs) possibly to be integrated with Millennium Development Goals (MDGs) for the post 2015 global policy architecture. Simultaneously the world in the past decade has entered into many new environmental agreements. Along with the governments also the private sector has been forthcoming. However, multilateral and bilateral funding dedicated to environmental purposes fluctuated and was faced with unmet promises to a great extent.

Sustainable Development and Climate Change in the Indian Context

In the past two decades, the key environmental challenges in India have been sharper. *The State of the Environment Report* by the MoEF clubs the issues under five key challenges faced by India –

1. Climate Change,
2. Food Security,
3. Water Security,
4. Energy Security, and
5. Managing Urbanisation.

Climate change is disturbing the natural ecosystems and is expected to have substantial adverse effects in India, mainly on agriculture (on which 58 per cent of the population still depends for livelihood), water storage in the Himalayan glaciers which are the source of major rivers and groundwater recharge, sea-level rise, and threats to a long coastline and habitations. Climate change

will also cause increased frequency of extreme events such as floods, and droughts. These in turn will impact India's food security problems and water security. As per the *Second National Communication* submitted by India to the UNFCCC, it is projected that the annual mean surface air temperature rise by the end of the century ranges from **3.5^0 C to 4.3^0 C,** whereas the sea level along the Indian coast has been rising at the rate of about **1.3 mm/year** on an average. These climate change projections are likely to impact human health, agriculture, water resources, natural ecosystems, and biodiversity.

SAPCC (State Action Plans on Climate Change)

After the NAPCC was launched[3], there have been serious efforts to dovetail national programmes of action to regional and local levels consistent with varying socio-economic and ecological conditions. At the Conference of State Environment Ministers held on 18 August 2009, the Prime Minister of India requested all state governments to prepare SAPCCs. The State Action Plans took their lead from National Mission documents while formulating mitigation/ adaptation strategies. So far, 21 states have prepared documents on the SAPCC focused on approaches that are sectoral but with regional ramifications. The State Action Plans include strategies and a list of possible sectoral actions that would help the states achieve their adaptation and mitigation objectives. The common threads that bind these State Plans together are the principles of territorial approach to climate change, sub-national planning, building capacities for vulnerability assessment, and identifying investment opportunities based on state priorities. This framework provides a broad, systematic, and step-wise process for the preparation of SAPCCs and advocates a participatory approach so that states have enough ownership of the process and final plan. The major sectors for which adaptation strategies envisaged are agriculture, water, forests, coastal zone, and health.

Concerned of the threats imposed by climate change and pressures on natural resources, sustainability and environment are increasingly taking centrestage in the Indian policy domain. India has been part of 94 multilateral environmental agreements. India has also voluntarily agreed to reduce its emission intensity of its GDP by 20-25 per cent over 2005 levels by 2020, and emissions from the agriculture sector would not form part of the assessment of its emissions intensity. Indian economy is already moving along a lower carbon and sustainable path in terms of declining carbon intensity of its GDP which is expected to fall further through lower carbon strategies. It is estimated that India's per capita emission in 2031 will still be lower than the global per capita emission in 2005 (in 2031, India's per capita GHG emissions will be under 4 tonnes of carbon dioxide equivalent (CO 2 eq.) which is lower than the global per capita emissions of 4.22 tonnes of CO_2 eq. in 2005).

Together with the national efforts in different sectors, India also recognises that rural areas are equally prone to stress and pressures from natural resource exploitation. In this context, schemes for rural development and livelihood programmes are very relevant. A vast majority of the works under the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) are linked to land, soil, and water. There are also programmes for non- timber forest produce-based livelihood, promotion of organic and low-chemical agriculture, and increased soil health and fertility to sustain agriculture-based livelihoods. These schemes help mobilise and develop capacities of community

institutions to utilise natural resources in a sustainable manner and their potential can be further developed.

Along with efforts to incorporate sustainability in the rural development process, India is increasingly making efforts to integrate the three pillars of sustainable development into its national policy space. In fact, environment protection is enshrined in our Constitution (Articles 48 A and 51 A [g]). Various policy measures are being implemented across the domains of forestry, pollution control, water management, clean energy, and marine and coastal environment. Some of these are policies like Joint Forest Management, Green Rating for Integrated Habitat Assessment, Coastal Zone Regulation Zone, Eco Labelling and Energy Efficiency Labelling, Fuel Efficiency Standards etc. Over a period of time, a stable organisational structure has been developed for environment protection. The country has been making fast progress in increasing its renewable energy capacity and has displayed the fastest expansion rate of investment of any large renewables market in the world in 2011, with a 62 per cent increase to $12 billion (Frankfurt School of Finance and Management *'Global Trends in Renewable Energy investment 2012'*). The 12th Plan with a prominent focus on sustainability makes provision and provides for many more opportunities like these.

Working on the social and economic pillars (sustainable development policies, programmes and targeted schemes) have been introduced to eradicate poverty either through a direct focus on economic indicators like employment generation, youth mobilisation, and building up assets of the poor; or indirectly through social indicators of human development with emphasis on health, education, and women's empowerment. As per the **Census-2011**, many parameters on this front have shown improvement, however, India is still not on target to meet some key MDGs by 2015.

- The *poverty* head-count ratio declined by 7.3 percentage points from 2004-5 to 2009-10;
- The *MMR* (maternal mortality rate) dropped from 301 per 100,000 live births in 2001-3 to 212 in 2007-9; and
- *literacy* rates have been constantly rising and are estimated to be 82.14 per cent for men and 65.46 per cent for women.

Over the years, arguments in favour of looking beyond the conventional measure of GDP and taking into account the environmental damage caused by production of goods and services received attention. An expert group under the chairmanship of Prof Sir Partha Dasgupta has been set up to develop a framework for 'Green National Accounts' for India. In fact, the Central Statistics Office (CSO) under the Ministry of Statistics & Programme Implementation (**MOSPI**) has been publishing comprehensive environment statistics since 1997. The process of putting in place a system for natural resources accounting was initiated by MOSPI way back in 2002.

Sustainable Development and Lower Carbon Strategies of the 12th Plan

The Twelfth Plan strategy[4] suggests that there are significant ***'co-benefits'*** for climate action with inclusive and sustainable growth. India as a large responsible player with very low income has also to ensure that these efforts are matched by equitable and fair burden sharing among countries, taking into account the historical responsibilities for emissions. These issues are being discussed in the UNFCCC.

India's approach to a lower-carbon growth strategy explicitly recognises that policies have to be

inclusive and differentiated across sectors according to national priorities, so as to lower the transaction costs of implementing the policy, and conform with a nationally fair burden-sharing mechanism. An Expert Group on Low Carbon Strategies appointed by the ***Planning Commission*** has outlined the lower carbon strategies for major potential carbon mitigation sectors.

1. **Power:** On the supply side, adopt super-critical technologies in coal-based thermal power plants; use gas in combined heat and power systems; invest in renewable technologies; and develop hydropower in a sustainable manner. On the demand side, accelerate adoption of super-efficient electrical appliances through market and regulatory mechanisms; enhance efficiency of agricultural pump sets and industrial equipment with better technology; modernise transmission and distribution to bring technical and commercial losses down to world average levels; universalise access to electricity; and accelerate power-sector reforms.
2. **Transport:** Increase the share of rail in overall freight transport; improve the efficiency of rail freight transport; make it price competitive by bringing down the levels of cross-subsidisation between freight and passenger transport; complete dedicated rail corridor; improve share and efficiency of public transport system; and improve fuel efficiency of vehicles through both market-based and regulatory mechanisms.
3. **Industry:** Greenfield plants in the iron and steel and cement sectors adopt best available technology; existing plants, **particularly small** and medium ones, modernize and adopt green technology at an accelerated pace, with transparent financing mechanisms.
4. **Buildings:** Evolve and institutionalise green building codes at all levels of government.
5. **Forestry:** 'Green India Mission' to regenerate at least 4 million ha of degraded forest; increase density of forest cover on 2 million ha of moderately dense forest; and overall increase the density of forest and tree cover on 10 million ha of forest, waste, and community lands.

Despite all these efforts, the reality that confronts us on the environmental front continues to be harsh and complex. Increasing population, urbanisation, and growing demand for water and land resources have severely impacted the quality and availability of water and soil resources. Rising energy needs is another area of concern. Besides, rapid growth will require corresponding growth in energy supply.

Presently, a large share of our energy demand is met through coal and oil and this trend will continue, given the unprecedented surge in energy demand and resource constraints. Energy issues become more complex with existing energy poverty and rise in energy prices. There is considerable scope for increasing efficiency in the use of energy and water in India together with other development indicators like infant mortality rate, MMR, sanitation facilities, and public health services. Economic instruments, regulatory measures, and market mechanisms can play an important role in helping to achieve development and growth in a sustainable manner.

INTERNATIONAL COLLABORATION AND EFFORTS

Admitting the well-founded concerns on the need to redress environmental problems, there were global calls for cooperation, action, and innovation. World leaders in 2012 continued to engage and deliberate in international forums dedicated to climate and environment and also in forums like the G20 where sustainable development and climate change were an integral part of the discussions. Ambition or goal setting to reach targets, provision of finance and technology for developing countries, and institutions and mechanisms for capacity building were the common threads of negotiations running through all these forums. Some of the high-profile events which the world was watching are discussed in the following paragraphs.

Rio + 20

The United Nations Conference on Sustainable Development (UNCSD), was held in June 2012, at Rio de Janeiro, Brazil, (also known as **Rio+20**) and was attended at the heads of states level. The objective of the Rio+20 Conference was to secure renewed political commitment for sustainable development, review progress made and identify implementation gaps, and assess new and emerging challenges since the UNCSD held 20 years ago in Rio de Janeiro in 1992. Towards the end, the Conference had two **themes** –

1. Green economy in the context of sustainable development & poverty eradication; and
2. Institutional framework for sustainable development.

The most significant outcomes of the Rio Summit have been the restoration of the principles of equity and of common but differentiated responsibilities (CBDR) in the global environmental discourse and placing poverty eradication at the centre of the global development agenda. The ***outcome*** also ensures the required domestic policy space to countries on a green economy and launched four processes/ mechanisms, i.e. developing SDGs, financing strategy, technology transfer, and defining the format and organisational aspects of the proposed high- level political forum to follow up on the implementation of sustainable development.

'Fairness' as an issue received attention. It is a matter of satisfaction and achievement for India that the Rio outcome document reaffirms equity and the principle of CBDR among other Rio principles. India together with other developing countries played an instrumental role in this. CBDR is especially important for developing countries, as it implies that while all countries should take sustainable development actions, the developed countries have to take the leading role in environmental protection, as they have contributed the most to environmental problems. Also they should support developing countries with finance and technology in their sustainable development efforts. India has always held that the eradication of poverty should be the overarching goal of sustainable development. This was given due recognition in the deliberations at the Rio Summit and in the outcome document.

On the issue of ***Green Economy***, the outcome document affirms that there are different approaches, visions, models, and tools available to each country, in accordance with its national circumstances and priorities, for achieving sustainable development. It identifies green economy in the context of sustainable development and poverty eradication as one of the important tools for achieving sustainable development but specifies that while it could provide options for policy-making it should not be a rigid set of rules. The outcome document clearly states what green economy policies should

result in and what they should not. It is a matter of satisfaction that the document firmly rejects prescriptive policies, unilateral measures, and trade barriers as well as unwarranted conditionality on **ODA** (Official Developmental Assistance) in this context.

The Rio+20 Conference will also be remembered for kick-starting the process on developing SDGs. The SDGs would address and incorporate in a balanced way, all the three dimensions of sustainable development and their inter-linkages. The SDGs would be universal, global, and voluntary. Since the SDGs are expected to become a part of the post-2015 UN development agenda, they would hopefully guide the international community towards inclusive sustainable development.

From India's point of view, SDGs need to bring together development and environment into a single set of targets. The fault line, as ever in global conferences, is the inappropriate balance between environment and development. Developing countries do not want any bindings on their efforts towards poverty eradication or any agreement that comes with such a price tag. Therefore, we could also view the SDGs and the post 2015 agenda as an opportunity for revisiting and fine-tuning the MDG framework and sustainably regaining focus on developmental issues. India and many developing countries are slow or off track in achieving targets under some of the MDGs, which have concrete areas of overlap between environment and development. This is another reason why these MDGs should continue to be a part of the post 2015 global policy architecture.[5]

The *Rio Summit did not lead to any specific commitments on the finance and technology* front. The developed countries, having obligations and responsibilities, need to commit to provision of adequate public funds including for transfer of technology and capacity building to developing countries. There has been no mention of provision of new and additional financial resources by developed countries, something that India would have wanted to see. Any new green economy and sustainable development goals would be meaningless without new money and technology commitments on the table. Nevertheless, we may hope that the follow up process of Rio + 20 on both finance and technology will keep these issues alive leading to some new strategies and mechanisms.

While developing countries remain disappointed with the outcome document on means of implementation, they managed to secure many of their key positions and demands in the negotiations. It says a lot about the current international situation that a reaffirmation of principles made 20 years ago is a sign of success. Convention on Biological Diversity 12.22 Global concerns about biodiversity found expression in the CBD adopted in 1992. The objectives of the Convention are: conservation of biodiversity, sustainable use of its components, and the fair and equitable sharing of benefits arising from the use of genetic resources. The Convention has near universal membership with 193 countries. The USA is the only major country that is not a part of it. Following the ratification of the CBD, India also enacted the Biological Diversity Act in 2002 and notified the Rules in 2004 to give effect to the provisions of the CBD.

Being committed to the cause, India successfully hosted the COP 11 to the CBD, and the sixth Conference of the Parties serving as Meeting of the Parties (CoP/MoP-6) to the CBD's Cartagena Protocol on Biosafety in Hyderabad from 8-19 October 2012. The event provided India an opportunity to consolidate, scale up, and showcase its initiatives and strengths on biodiversity. One of the most important outcomes is the commitment of the Parties to doubling the total biodiversity-related international financial resource flows to developing countries by 2015 and at least maintaining this level until 2020. This will translate into additional financial flows to the developing

countries to the tune of about US $ 30 billion over the next eight years.

The Prime Minister of India, during COP 11 announced India's ratification of the Nagoya Protocol on Access and Benefit Sharing under the CBD and also launched the 'Hyderabad Pledge' of US $ 50 million during India's Presidency to strengthen institutional mechanisms and capacity building in developing countries. The Prime Minister unveiled a commemorative pylon in Hyderabad to mark COP- 11. It has been decided to establish a biodiversity museum and a garden on this site. At national level, efforts will be made to strengthen the implementation of the Biological Diversity Act and provide support to the State Biodiversity Boards and at local level prepare Peoples Biodiversity Registers. Doha Climate Change Conference 2012.

The 18th session of the COP to the UNFCCC, that started on 26 November and concluded on 8 December 2012 in **DOHA**, Qatar has resulted in a set of decisions (clubbed together as **'Doha Climate Gateway'**) aimed at advancing the implementation of the UNFCCC and its Kyoto Protocol (KP). The key issues for the Doha conference were –

i. Amending the **KP** (Kyoto Protocol) to implement the second commitment period under the Protocol;

ii. Successfully concluding the work of the **BAP** (Bali Action Plan) within which there was urgent need for a clear path to climate finance; and

iii. Planning the work under the **DP** (Durban Platform) for enhanced action.

The Conference addressed all three issues and came out with a package which balanced the interests and obligations of various countries.

At the Doha Conference, the three issues of equity, technology-related IPRs, and unilateral measures raised by India resounded in the decisions. These outstanding or unresolved issues under the BAP are now part of the planned or continuing work of various bodies of the Convention. At Doha, India also ensured that no hasty decision was taken on aspects related to mitigation in agricultural sector at global level as agriculture is a sensitive sector for developing countries. The Conference has explicitly recognised that the action of Parties will be based on equity and CBDR including the need for equitable access to sustainable development. The Conference also recognised that issues relating to global peaking that could place a cap on emissions of developing countries and restrict their development space were controversial and best avoided at this stage of development. At the same time, in an effort to cater to the interest of all countries and come up with a balanced package, some elements of the package required compromise or deferral. In many cases, ambitious and strong demands were collectively made by developing countries, but in the act of balancing, countries were made to accept the mellowed down and subtle versions of their demands. Among the key concerns which the Conference could not address were those relating to financing commitments of developed countries and sectoral actions. No specific targets for mid-term financing (2013-2020) were adopted. While the Conference stopped short of giving a mandate to the International Civil Aviation Organisation (ICAO) or International Martine Organisation (IMO) to initiate steps for curtailing emissions in their respective sectors, the absence of a decision on sectoral framework for such actions has left open the possibility of such actions being initiated in such sectors by the respective international organisations. considering the fact that some of the leading members of ICAO prefer a global market based mechanism to be the vehicle of such actions, the framework and the principles on the basis of which such actions will be taken are likely to be a bone of contention for quite sometime.

Also, despite vociferous demand from vulnerable countries, there could be no satisfactory agreement on a compensation mechanism for loss and damage resulting from climate change.

KEY DOHA OUTCOMES

Important outcomes at the Doha Summit may be summarised as follows: –

1. It has been agreed that the KP, as the only existing and binding agreement under which developed countries commit to cutting emissions of GHGs, will enter a second commitment period that will run for eight years.
2. Governments have agreed to speedily work toward a climate change agreement under DP applicable to all countries from 2020, to be adopted by 2015. Further governments have decided to find ways to scale up efforts before 2020 to meet the gap in global ambition for emissions reduction.
3. Governments have launched a robust process to review the long-term temperature goal. This will start in 2013 and conclude by 2015 and is a reality check on the advance of the climate change threat and the possible need to mobilise further action.
4. The Work Programme on Long term Finance launched last year has been extended for another year to contribute to the ongoing efforts to scale up mobilisation of climate finance. Developed countries have reiterated their commitment to deliver on promises of mobilising US$100 billion both for adaptation and mitigation by 2020.
5. Decision also encourages developed countries to increase efforts for providing finance between 2013 and 2015, and at least to the average annual level provided during the 2010-2012 fast-start finance period.
6. Finance pledges of about $ 6 billion for period upto 2015 announced by Germany, the UK, France, Denmark, Sweden and the EU Commission.
7. The selection of the Republic of Korea by the Board of the Green Climate Fund (GCF) to host the GCF has been endorsed.
8. The unresolved issues of Technology-related Intellectual Property Rights (IPRs) and the Unilateral Measures under the BAP are now part of the planned or continuing work of various bodies of the Convention. Based on the decisions, the Technology Executive Committee (TEC) will initiate exploration of issues relating to enabling environments and barriers, including IPRs in its future work-plan. The TEC has already identified IPRs as one of the key messages on which further work is necessary. Similarly, a decision has been taken for facilitating discussion on the issue of unilateral measures under the existing forum on implementation of response measures.

Source: **Economic Survey 2012-13,** MoF, GoI, N. Delhi, p. 261.

On the positive side, the Doha Conference succeeded in carrying out amendments to the KP to ensure a second commitment period. The second commitment period will last for a period of eight years as of 1 January 2013. This decision has ensured that there will be no gap between the first commitment period under the KP ending on 31 December, 2012, and the second one commencing on 1 January, 2013. With the exception of Russia, New Zealand, Japan, and Canada, all other countries that were

part of the first commitment period entered into the second round, with some new countries joining as well. It has been agreed that the KP Parties will revisit their targets in 2014 with a view to increasing their ambition.

The emission reduction obligations undertaken by the KP Parties are not as ambitious as required by science; however, they provide a relative degree of certainty to the carbon markets. The EU will reduce its emissions by 20 per cent by 2020 compared to 1990 (Table 12.1). Governments also agreed to speedily work under the DP to evolve a new set of arrangements for mitigation commitments and actions applicable to all countries from 2020, and to adopt it by 2015. In a significant and positive advancement, it has been agreed that the work of the DP will be based on the principles of the Convention.

CO_2 Emissions of the G 20 Countries

CO_2 being the predominant GHG, an analysis (of the *World Bank*) of its emissions across countries in per capita terms in 2009, compared to 2005 presents an interesting picture. Although the G20 is referred to as a group, there are stark disparities on the ground between member countries in terms of incomes, stages of development as well as respective per capita CO_2 emissions. In 2005 –

- the USA had the highest CO2 emissions in metric tons per capita at 19.7, followed by Australia (18.0).
- the lowest per capita emitters in 2005 were Brazil (1.9), Indonesia (1.5), and **India** (1.2) who continued to be the bottom three in 2009 as well.
- In 2009, Australia ranked first within the G20, followed by the USA.

Source: **Economic Survey 2012-13,** MoF, GoI, N. Delhi, p. 262.

DISCUSSIONS UNDER G 20

G20—the group of twenty major economies of the world took up the agenda of inclusive green growth during the Mexican Presidency in 2011-12. The aim of introducing inclusive green growth into the G20 agenda was to support the transition of developing countries, in particular the low income countries, towards becoming lower carbon economies as well as to enable countries to become more resilient to climate change. As of now, the G20 ministers have agreed to voluntarily self-report in 2013 on their respective country's efforts to follow inclusive green growth and sustainable development policies under their structural reform agendas. Leaders at the G20 last year also collaborated to form a Climate Finance Study Group to consider ways of effectively mobilising resources taking into account the objectives, provisions, and principles of the UNFCCC.

FINANCING CLIMATE CHANGE

The idea of a global budget for carbon and its corresponding financing stems from the objective of

stabilising the GHG concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. There has already been a 0.8 ^{0} C increase in global mean temperature. It is widely believed that we are fast approaching the 2^0 C temperature rise within which the global community is striving to limit itself. This indicates that only a small and fast closing window of opportunity exists for the international community to take actions and ensure that we avoid reaching this point.

Yet the question remains that how to finance actions to achieve this target[6]. A UNFCCC paper (2007) estimated a requirement of US$ 200-210 billion in additional annual investment in 2030 to return GHG emissions to current levels. Further, additional investment needed worldwide for adaptation was estimated to be annually US$ 60-182 billion in 2030. However, with the passage of time and inadequate action, these estimates are being revised upwards. Most recent estimates presented at the UNFCCC's workshop on Long-term Finance (July 2012), point to an even more enormous scale of funds, in the range of $600-$1500 billion a year, that would be needed by developing countries for mitigation and adaptation. This amount is at least 5-10 times the prospective financing flows of US$100 billion per year by 2020 agreed upon as the goal under the UNFCCC. Representatives from the International Energy Agency reported at this workshop that annual global investments for power generation alone, in a 2 ^{0} C temperature rise scenario, would involve $370 billion from 2010 to 2020; $630 billion between 2020 and 2030; and $760 billion between 2030 and 2050.

Domestic Resources and Mechanisms

The UNFCCC (The latest available data of actual emissions available is upto 2010 only) notes that Kazakhstan, Cyprus, Malta, and Belarus did not have reduction commitments for 2008-2012 under the KP. Canada, Japan, New Zealand and Russia are not Parties to the second commitment period to the **KP** (Kyoto Protocol): Countries that are undergoing the process of transition to a market economy. For any representative country say for Australia, the table shows that in the first commitment period, Australia could collectively increase emissions by 8 per cent between 2008-2012 (taking the base year as 1990), whereas for the second KP round, Australia would need to reduce its emissions by 0.5 per cent collectively between 2013- 2020. The last two columns of the table measure progress towards the first KP target which shows that Australia's actual emissions increased by 30 per cent between 2008-10. This indicates that for the period between 2010-2012, Australia's emission should have been reduced by 22 per cent for it to be within the target.

CARBON TAXES AND ENVIRONMENTAL SUBSIDIES

A recent study 'Preliminary Modeling Studies on Carbon Taxes and GDP Loss' was conducted by the Ministry of Environment and Forest, GoI. The results of the study are given as below –

Undiscounted cumulative GDP loss: Carbon tax is *revenue positive* when it involves no adjustment to other tax rates in the economy. It is *revenue neutral* when other tax rates are adjusted so that the revenue inflow from carbon tax is exactly balanced by an equal reduction in yields from reduced taxes.

GoI Expenditure on Environment Promoting Subsidies

Environment-promoting Subsidies	Exp. in 2008-09 (Rs. crore)
Sewerage & sanitation	1236.06
Soil & water conservation	26.04
Fisheries	221.52
Forestry & wildlife	696.36
Agricultural research & education	365.11
Special areas development prog.	1560.29
Flood control & drainage	175.28
Non-conventional energy	477.21
Ecology & environment	473.80
Total	**5231.67**

Source : A Technical Paper on *'Environmental Subsidies in India: Role and Reforms'* by the Madras School of Economics (January 2012), as quoted by the *Economic Survey 2012-13*, p. 264.

The assessment and quantification of the costs of adaptation and mitigation is a difficult task. However, it is clear that these costs are significant and will likely be higher in the future as initiatives are taken in line with the goals outlined in the NAPCC. The preliminary estimates indicate a sum of ' 230,000 crore to fulfill the mission objectives under the NAPCC alone, let alone other lower carbon strategies and environment policies and programmes of the government.

The most obvious source of financing for climate change action is government budgetary support. Most of it would come as sectoral finance since some of the resources for adaptation and mitigation are built into the ongoing schemes and programmes. Although mitigation is sometimes an important co-benefit, the deployment of resources for such purposes is largely guided by the overall availability of resources. The Finance Bill 2010-11 created a corpus called the National Clean Energy Fund (NCEF) out of a cess at the rate of Rs.50 per tonne of coal to invest in entrepreneurial ventures and research in the field of clean energy technologies. The government expects to collect Rs. 10,000 crore under the NCEF by 2015. Governments have a range of policy instruments and variables at their disposal to use for generating the enormous resource requirements in this field. This includes a set of price signals, direct and indirect taxes, subsidies, and export and import levies. Theoretically, environment- related taxes have an important role to play in funding green initiatives. At the same time, any government must use these policy tools after serious consideration and analysis as they may have serious repercussions on other sectors of the economy. Preliminary modelling studies by the Ministry of Environment and Forests indicate that even a modest revenue-neutral economy-wide Carbon tax of US$10 per ton of GHG emissions in India would result in a GDP loss of around US$ 632 billion at 2005 prices. At the same time, the government continues to use subsidies to promote the environment.

Carbon taxes and *subsidy* may not be relied solely as the most viable policy option. Therefore, India is experimenting with a careful mix of market mechanisms together with fiscal instruments and

regulatory interventions. On one hand, where the cess on coal is a type of carbon tax being levied in India, **PAT** (Perform Achieve and Trade) and **RPO** (Renewable Purchase Obligation) are examples of cap and trade market mechanisms promoting energy efficiency and the use of renewable energy respectively in India.

The Twelfth Plan, in the particular context, lower carbon strategies will require capital finance for improvements in technology and enhanced deployment of renewable and clean energy technologies. Some of these objectives may be met through regulatory interventions and use of market mechanisms, in which case the required budgetary support may be small. In other cases, adequate financial outlays will be needed to implement policies and measures that can achieve specific mitigation outcomes in the individual sectors. So far, three grants of Rs. 5,000 crore each, for forest cover, renewable energy, and the water sector, have been recommended by the 13th Finance Commission for the state governments.

Considering the large resource requirement, arguments in favour of setting up a **National Green Fund** to finance public and private sector projects/ activities aimed at protecting environment in accordance with the Twelfth Plan objectives have found support. The Fund could also be a vehicle for receiving international support through agreed bilateral and multilateral sources and can finance actions not only at national level but also at state level for agreed priorities and thrust areas.

Carbon offsetting and its requisite financing require global effort and process. Markets that are operating take signals from international negotiations. Domestic markets and mechanisms alone are neither sufficient for generating resources of the required scale nor efficient enough for reaching the set level of targets and therefore rely heavily on international policy architecture. The second commitment period of the KP has brought some respite and certainty to the carbon markets; however, due to lack of ambition the future of carbon markets could still be in an indeterminate state. India's actions for climate change will, therefore, need to be financed from a pool of resources consisting of domestic resources, international carbon finance, and multilateral funds.

International Sources and Issues

India, primarily out of its own concerns, has chalked out ambitious plans and policies to tackle climate change and environment issues that reflect India's strong will to address this global public good. However, given the *scarcity of resources* and competing demands, finding the matching resources is a challenge. The 'Expert Group on Low Carbon Strategies' has also stated in its Interim Report that aggressive mitigation cannot be achieved without substantial international financial support, both in terms of financial resources and technology transfer. The Indian PM also echoed similar sentiment in his **Rio+20 Summit** speech: *'Many countries could do more if additional finance and technology were available. Unfortunately, there is not enough evidence of support from the industrialised countries in these areas.'*

PAT and RPO

The ***PAT*** (perform - achieve - trade) is a scheme for trading energy-efficiency certificates in large energy-intensive industries under the National Mission for Enhanced Energy Efficiency –

- Identified industries are required to improve their specific energy consumption (SEC) within

the specified period of three years or face penalty provisions.

- At the same time this mechanism facilitates efficient industries to trade their additional certified energy savings (that go beyond the assigned target) with other designated consumers who could use these certificates to comply with their SEC-reduction targets.
- In the Twelfth Five Year Plan, the PAT scheme is likely to achieve about 15 million tonnes oil equivalent of annual savings in coal, oil, gas, and electricity (including 6.686 million ton of oil-equivalent energy savings of first phase).

Similarly, the ***RPO*** (Renewable Purchase Obligation) is creating domestic markets for renewable energy through regulatory interventions at state level.

- The RPO is the minimum level of renewable energy (out of total consumption) the obligated entities (DISCOMs, Captive Power Plants, and Open Access Consumers) are entitled to purchase in the area of a distribution licensee.
- The obligation is mandated by the State Electricity Regulatory Commission (SERC). Since the renewable energy sources are not evenly spread across India, SERCs cannot specify a linear level of RPOs for all states.
- Renewable Energy Certificates (RECs) under the RPO mechanism is an instrument that enables the obligated entities to meet their Renewable Purchase Obligation by trading surplus or deficit RECs among themselves with the owner of the REC being able to claim to have purchased renewable energy.

Source: **Economic Survey 2012-13,** MoF, GoI, N. Delhi, p. 265.

In the context of making finances available to developing countries, in the recent past, much of the talks under the UNFCCC revolved around two numbers, namely US$ 30 billion between 2010 and 2012 as **FSF** (Fast Start Finance) and US$ 100 billion annually by 2020 as long-term finance. These were the two finance figures that the developed world collectively pledged as climate change finance in 2009. These pledges need to be new and additional. The term *'new and additional'* in the context of provision of finances by developed countries can be traced right from the text of the Convention to various COP decisions. In this sense 'new and additional' refers to provision of financial resources that represent new commitment, rather than those that are diverted from flows that have already been earmarked for some other form of development assistance.

However, in the absence of an agreed definition of additionality in climate finance, the developed and developing countries have diverging views. In the backdrop of these differences, together with great uncertainty in finance flows, complex web of channels, and lack of transparency and reporting practices, the actual additionality on FSF turned out to be a matter of great contention *(given below in the box)*. These differences more recently led to demand from developing countries on the need for a mechanism to **MRV** (*measure, report, and verify*) climate finance flows.

Assessing the US$ 30 Billion FSF Commitment (2010-2012)

Many studies echoed serious concerns on the way FSF was implemented, at the time the FSF came to an end in 2012. There are lessons to be learnt so that these issues are addressed when we implement long-term finance by 2020. As a part of the FSF assessment, an **Oxfam** study ***The***

Climate Fiscal Cliff reveals five numbers that speak for themselves on the delivery of funds under FSF –

i. Only 33 per cent of FSF appears to be new money;

ii. Only 24 per cent of public finance was additional to existing aid promises;

iii. Only 21per cent went for supporting adaptation in spite of promises to balance it with mitigation;

iv. Only 43 per cent was provided as grants and the rest as loans; and

v. Only 23 per cent was channeled through multilateral funds.

Almost all assessments on FSF point to the core problems as being (a) that it was recycled money either diverted from ODA or made up of funds delivered or planned before the Copenhagen promise in 2009; (b) that the most vulnerable were not prioritised, with minimal funds spent on adaptation and (c) net transfer of resources to developing countries was not even half the amount promised as more than 50 per cent was in the form of loans that have to be repaid. Therefore, an important takeaway in the context of the long-term finance flows are lessons on transparency, coherence, and consistency in reporting and verifying climate finance flows.

Source: **Economic Survey 2012-13,** MoF, GoI, N. Delhi, p. 266.

As a part of the ***finance package*** in the Doha Conference, the MRV of finance was an important element of the deal. It is satisfying that elements of MRV will be taken up by the Standing Committee on Finance under the COP. The Committee will consider ways of strengthening methodologies for reporting, measuring, and tracking climate finance. Talking about other finance elements, the Conference did not take ambitious or meaningful decisions especially on the demand for finance for the period between 2013 and 2020. The final decision encourages developed country Parties to increase efforts for at least maintaining the average annual 2010-2012 level of finance between 2013 and 2015. On the other hand, it is reassuring that the work programme on long-term finance started in COP17 in Durban has been extended with a view to continuing discussion on likely sources of finance in the long term. To sum up, finance negotiations and outcomes at Doha were in the nature of small slow steps rather than big strides.

Simultaneously, there have been efforts to build the requisite infrastructure for enabling and facilitating the flows of climate finance under the Convention. This is because only scaling up of finance will not suffice. The money should be put to efficient use and generate results. To this effect, work on operationalising the GCF progressed. The Republic of Korea has been selected as the host country to house its secretariat. The GCF is expected to be instrumental in channelling a significant share of the US$ 100 billion expected annually to be mobilised to developing countries by 2020 for addressing climate change. The vision, structure, and strategy of the Fund to carry out its function are a crucial priority on the agenda of the GCF Board. The Board should not rush with the ‘standard’ solutions sometimes proposed by outside interests but focus on ultimate goals and results on the ground with accountability and transparency.

Meanwhile, there are other Funds under the UNFCCC which continue to function. Collectively, the climate focal area of Global Environment Facility (GEF), the Special Climate Change Fund, the Least Developed Countries Fund, and the Adaptation Fund disburse around less than US$ 1 billion per year

(Report on the workshop of the work programme on long-term finance 2012). The GEF, which is also an operating entity of the financial mechanism of the UNFCCC like the GCF, provides project grants for addressing global environmental issues while supporting national development initiatives. Till date, India has accessed about US$ 438 million of GEF grant of which US$ 269.5 million is for projects under the climate change focal area. At the same time, the **CIF** (Climate Investment Fund) – a collaborative effort among the multilateral development banks is offering its funds to be used for climate action on the basis of agreed terms and conditions. India has agreed 'in principle' to accessing the CIF, provided it is not treated as part of the climate change finance flows under the Convention and no GHG emission reduction related conditionalities are associated with the funds. The Trust Fund Committee in May 2012 has approved the allocation of the first tranche amounting to US $ 263 million for four projects contained in India's Investment Plan.

Carbon Markets and Private Sector

Visible disappointments with the Doha outcomes on finance, many observers warned that we are heading towards a climate fiscal cliff. In this context, the private sector and global carbon markets are being increasingly emphasised. While not sufficient in themselves, the private sector and carbon markets have shown significant potential in mobilising finance for climate change especially for mitigation action.

As per the UNFCCC report on long-term finance, of the estimated current international climate financial flows, US$ 55 billion per year was generated from the private sector. Likewise, carbon markets help developing countries to find financial resources to proceed on their sustainability efforts. The CDM (the KP's market mechanism) as the world's largest carbon market has helped mobilise more than US$ 215 billion collectively so far in investments in developing countries (CDM Policy Dialogue Report). India has been an active player in the CDM, with over 2000 projects having been accorded host country approval, which has the potential of facilitating an overall inflow of approximately US $ 7.07 billion if all the projects get registered.

Both these sources, at the same time, have serious limitations in terms of predictability and adequacy of flows. It is absolutely clear that they will not deliver on the hardest things: equity, public goods, and adaptation such as climate resiliency in agriculture or offgrid distributed renewables for poor regions. They will instead prove useful for market- led goods and services for the better, such as grid-based solar and wind power, where public subsidies in one form or another will be demanded. Also private sector investment is guided by risk return. This explains the strong inclination of the private sector towards mitigation projects. Adaptation financing continues to be a concern for all developing countries with insignificant private participation as adaptation usually does not yield returns on investment.

Carbon markets on the other hand are volatile, where success is contingent on the level of collective mitigation of ambition of nations. The end of the first phase of the KP saw the CDM market collapsing with carbon prices declining around 70 per cent in the past year alone. Moreover, unilateral restrictions imposed by the authorities in some of the major carbon markets such as EU on carbon credits from major developing countries such as India have not helped matters. The prices of carbon credits are likely to remain in a trap until the global ambition improves and new market mechanisms emerges to take into account the pledge based emissions. Both the carbon markets and private money

need clear and targeted signals from public policies to address the institutional and market barriers confronting them.

PROBLEMS & PROSPECTS

Though multilateral efforts on sustainable development and climate change have led to several positive outcomes, there are still areas of concern where further work is needed to safeguard the interests of developing countries in future deliberations. Some of the challenges and deliverables from India's point of view are –

i. Follow up and action on the Rio + 20 outcome document, and the four processes/mechanisms that were as part of it, especially on developing SDGs and the processes on the financing strategy and technology transfer.
ii. Taking forward the climate change discussions at Doha, the key question to be addressed is to articulate equality in the evolving arrangements that will be applicable to all in the post 2020 period. We have to ensure that domestic goals continue to be nationally determined even as we contribute to the global efforts according to the principle of CBDR and respective capabilities.
iii. Taking concrete decisions on the sectoral framework for such actions closing the possibility of both unilateral measures and actions being initiated in sectors by the respective international organisations like ICAO or IMO on their own.
iv. Equity, fair burden sharing, and equitable access to global atmospheric resources have to be protected and addressed more adequately under the DP, India will have to fight for its fair share of carbon and development space.

The sources and channels of providing long-term finance by developed countries have not yet been clearly identified. With no certainty on funding in the coming years, it is absolutely necessary to expeditiously mobilise finance and provide initial capital to the GCF for its operations.

Based on historic emissions and responsibilities, developed countries should take the lead. However, according to a June 2011 Study[7] , developing countries are pledging greater cuts in their GHG emissions than developed countries.

India is also proactive in this regard with its intentions and ambition firmly in place in its policies and programmes. One may rightly argue that with the Twelfth Plan's focus on 'environmental sustainability', India is on the right track with the right enabling environment and has a number of achievements to its credit. However, the challenge while India is growing is to identify the key drivers and enablers of growth be it –

- Infrastructure
- Transportation sector
- Housing, or
- Agriculture

And finally, to make the above-given sectors grow sustainably. This leads us to the next and most **vital issue** of finding and raising new and additional resources for meeting economic well-being

needs with greater environmental sustainability. More often, it is the resource crunch which is the stumbling block for developing countries like India. While it makes efforts to efficiently and expeditiously bring price signals and other policy instruments into play, India could do much more if new and additional finance and technology are made available through multilateral processes.

"Be it national or global, environmental decline and global warming occurred gradually over decades and centuries, picking up pace with time. We must remember that the clock is now ticking on the needed global action to combat and contain this decay. This action should be fair, just and equitable for all countries so that our future has ecological and economic space for sustainable development for all".[8]

Moreover, mankind is faced with a situation when, by all means, it develops and selects the kind of 'technologies' which have the minimum or least 'fallouts' on our eoclogy and environment in the process of promoting the cause of mankind's development. Absence of global concensus cannot be cited by the individual nations as a refuge to sit idle and continue in the mode of 'business as usual'. Before it is too late, the conscience of humanity must awaken from its inertia.

EPILOGUE

Hardly anything makes economic sense unless its continuance for a long time can be projected without running into absurdities.[9] Growth and development can happen to a 'limited objective', but it cannot be stretched upto an 'unlimited extent'. How can the 'finite' earth support mankind's 'infinite' physical needs? – long before this was postulated by the 'Club of Rome' in 1972, exactly the same thing Gandhiji had said in late thirties itself, 'Earth provides enough to satisfy every man's need, but not for every man's greed'. Mankind needs to introspect not only about its present needs but the way those needs are bieng met.

Besides, we also need to 'differentiate' between our 'needs' and 'aspirations'. Our physical needs have a direct 'link' with the resources we have at our disposal to meet them. If mankind is to survive and prosper, we need to be aware of the repercussions of our activities on Mother nature.

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1. Oliver Morton in **'Megachange: The World in 2050',** edited by Daniel Franklin & John Andrews, *The Economist*, London, 2012, pp. 92-110
2. 'Megachange: The World in 2050', op. cit., pp. 94-96.
3. **NAPCC**, Ministry of Forest & Environment, GoI, Final Draft March 31, 2011, N. Delhi.
4. Twelfth Five Year Plan 2012-17, Planning Commission, GoI, N Delhi, 2012.
5. **Economic Survey 2012-13,** MoF, GoI, N. Delhi, p. 259.
6. ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 262.
7. Stockholm Environment Institute, 'Comparison of Annex 1 and non-Annex 1 pledges under the Cancun Agreements', as cited by the ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 268.
8. ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 268.
9. These virtuous opinions can be seen in a number of contemporary thinkers and writers since 1970s:

   E. F. Schumacher, '***The Economics of Permanence***', *Resurgence,* Volume 3, No. 1, May/June 1970, (reprinted in Robin Clarke, Editior, '***Notes for the Future: An Alternative History of the Past Decade***', Thames & Hudson, London, 1975).

Schumacher invoked Gandhi while advocating for the ‘economics of permanence’.

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PREPARING FOR THE DEMOGRAPHIC DIVIDEND

*India is a glaring example of demographic dilemma – while rate of population growth is a matter of concern at one hand, at the other it also unfolds opportunity because children and youth account for a large share of this growth. It is an advantage for India now because the country is entering the demographic dividend phase while China is exiting it – demographic dividend refers to a period, usually, 20 to 30 years – when a greater proportion of people are young and in the working age-group. This cuts spending on dependants, spurring economic growth. India hopes that by the time this dividend phase ends around 2045, it would have achieved a stable and balanced population.**

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- Comparing Growth and Trade
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* See different reports of the *United Nations Population Fund, United Nations Children's Fund* together with the *Economic Surveys 2010-11/2011-12/2012-13.*

INTRODUCTION

As the developed world is in the process of greying and are heading for a crunch in the 'working population', nations with growing population in the working age-group see this as an opportunity to employ their surplus manpower in there nations. In case of India, the situation has been considered to be highly favourable by international as well as Indian experts. But these are mere aspirations. To reap real diridends, we need to provide the required 'quality' to the quantity of our population. We need to strengthen our human resource development capabilities keeping in mind the future requirements. Only then the dividend of demography will be in India's favour.

The *Economic Survey 2012-13*, on the India's prospects of garnering demographic dividend, says, "Policymakers are usually focused on short-run economic management issues. But the short run has to be a bridge to the long run. The central long-run question facing India is 'Where will good jobs come from?' Productive jobs are vital for growth. And a good job is the best form of inclusion. More than half our population depends on agriculture, but the experience of other countries suggests that the number of people dependent on agriculture will have to shrink for per capita incomes in agriculture to go up substantially. While industry is creating jobs, too many such jobs are low productivity non-contractual jobs in the unorganized sector, offering low incomes, little protection, and no benefits. Service jobs have relatively high productivity, but employment growth in services has been slow in recent years. India's challenge is to create the conditions for faster growth of productive jobs outside agriculture, especially in organised manufacturing and services, besides improving productivity in agriculture. The benefit of rising to the challenge is decades of strong inclusive growth".

Optimism vs Pessimism

Experts with optimistic views are confident in India's demographic dividend because of the fact that India's dependency ratio, as measured by the share of the young and the elderly as a fraction of the population, will come down more sharply in the coming decades. More working age people will mean more workers, especially in the productive age groups, more incomes, more savings, more capital per worker, and more growth. Also, because demographic change is associated with fertility declines, the transition period may be accompanied by greater female participation in the labour force[1].

As per the IMF, every fast-growing Asian economy in recent years has accelerated as it underwent a demographic transition. In India[2] itself, the high growth states (Tamil Nadu, Karnataka, and Gujarat) in the period 1991-2001 had a dependency ratio which was 8.7 percentage points lower than that of the low growth states (Bihar, Madhya Pradesh, and Uttar Pradesh) and an average annual growth rate that was 4.3 percentage points higher. Looking ahead, the low growth states will benefit more from the demographic dividend, as higher incomes and lower fertility alter demographics. Indeed, over the period 2001-11, the hitherto laggard states have grown at an average of around 5 per cent annually. The difference between their growth and that of the leaders in the period 2001-11 is just 1.5 percentage. So demographic transition seems to be correlated with growth, with some reasons to believe that causality flows both ways i.e., lower dependency ratios increase growth and higher growth reduces fertility and consequently dependency ratios.

These optimists point to another reason for cheer. Cross-country evidence suggest that productivity is an increasing function of age, with the age group 40-49 being the most productive because of work experience[3]. Nearly half the additions to the Indian labour force over the period 2011-30 will be in the age group 30-49, even while the share of this group in China, Korea, and the United States will be declining. That India will be expanding its most productive cohorts even while most developed countries and some developing countries like China will be contracting theirs in the coming decades can be another source of advantage.

However, the as pessimists are not convinced. A larger workforce translates into more workers only if there are productive jobs for it. Will there be enough productive jobs? One way to make progress in answering this question is to understand the commonalities as well as the differences between India's growth path and that of other populous fast growing Asian economies. By comparing where India is today, with where those countries were at similar stages in their development, as well as by looking at what they did next, we might get a better perspective on what India might need to do. Of course, any such analysis has to be accompanied by two important caveats –

i. First, countries differ and do not necessarily follow similar trajectories;

ii. Second, the global environment has changed.

The opportunities India faces now are different from those that previous fast growers faced when they were at a similar stage of development. Thus, blindly replicating their trajectory may be unwise.[4]

COMPARING GROWTH AND TRADE

If we analyse the various economic outcomes for selected Asian countries around their dates of initial 'takeoff' into periods of high growth, we identify the year of takeoff for comparator Asian countries based on IMF (2006)[5] the dates are 1979, 1973, and 1967 for China, Indonesia, and Korea respectively. For India, taking the year of takeoff as 1991, when major economic reforms began, the following narrative is clear as given below :

- India was growing at similar rates as other Asian economies before takeoff. After takeoff, it kept pace with Indonesia, but China and Korea grew faster.
- Setting date 0 as the year the country's per capita GDP in 2000 US dollars, crossed $500;
- By the time India's dependency ratio falls below 40 per cent, China's growth is more robust under both these alternatives, while India's matches that of Indonesia.
- Korea's trajectory is similar to India's in the initial years after takeoff, though after 10 years the slope of its trajectory increases steeply.
- By plotting an index of a country's share of world trade, with year 0 based on our first takeoff definition (1979, 1973, 1967, and 1991 for China, Indonesia, Korea, and India respectively). interestingly, India's growth in its share of world trade is similar to China's and greater than Indonesia's at similar periods after takeoff. India's openness is also evidenced by the trade to GDP ratio, which exceeded 55 per cent in 2011. By contrast, this ratio is only 31 per cent for the United States.
- The takeaway from the evidence examined so far is that India's growth performance has been

similar to that of some of the fast-growing Asian economies at similar stages after takeoff, but not as spectacular as China's. Interestingly, despite being seen as a trade laggard, India has grown more open to trade at about China's pace.

Sources of Growth

For knowing the edge India has in garnering 'demographic dividend', a comaprision with the other Asian economies – in the area of ***sources of growth*** will serve the purpose.

- Growth in per capita income is driven by growth in labour productivity (what the average worker produces), growth in working age population (fewer the people who are in the dependent age group in the population, greater the output), growth in the fraction of those who can work and that actually look for work (labour force participation rate), and growth in those looking for work who actually find it (employment rate).
- Because accurate employment data are hard to find for developing countries, studies typically ignore the employment rate in decomposing the sources of growth. A decomposition of per capita income growth during the 20 years after takeoff suggests that across countries, much of the increase in per capita income comes from greater labour productivity.
- Interestingly, except for Korea, **LFP*** (labour force participation) has fallen on an average annual basis, so it subtracts from growth.
- Finally, the increase in the share of WAP (working age population) seems to add only a little to growth.
- Since the increase in working age population is what we call the demographic dividend, the fact that it contributes so little to growth (on average, 0.5 percentage points for India in the 20 years since 1991) may seem a puzzle.

The puzzle can be solved this way – the increase in the fraction of people working is probably not the main consequence of the demographic dividend. Instead, the effects of the demographic dividend are channelled through the increase in labour productivity, which comes from more physical capital employed per worker (in turn resulting from greater saving and investment), more human capital per worker (which comes from more education as smaller families lead to greater spending on education per child), and greater **TFP** (total factor productivity).**

Therefore, it is useful to see how much each of these factors contributed to labour productivity. Better *human capital* accounts for only a small part of the growth in labour productivity for Asian fast growers. Instead, the two biggest contributors are the growth in capital deployed per worker and growth in TFP. Indonesia and Korea relied much more on capital deepening. India did not have as much growth in capital per worker as these countries but had stronger growth in TFP. Finally, China grew both because of more capital deployed as well as strong increases in TFP.

Quite interestingly, in the years beyond the 20th year after takeoff which India is now entering, capital deepening slowed for both Indonesia and Korea but it increased for China. More interestingly, TFP slipped considerably for Indonesia and was not large for Korea to begin with. However, it increased for China.

Precisely speaking, the underpinnings for continued strong Chinese growth in the years beyond the second decade after takeoff are a robust investment rate as well as substantial increases in the

intrinsic productivity of jobs. If India were to follow a similar path, it would need to increase savings and investment, both of which will follow from the demographic transformation. But it will also have to increase the intrinsic productivity of jobs, that is TFP.

IMF *(World Economic Outlook-2006, 'Asia Rising: Patterns of Economic Development and Growth', Chapter 3)* suggests that a significant portion of China's increase in TFP has come as workers migrate from low-productivity sectors like agriculture to high-productivity sectors like manufacturing. What lies ahead for India? A recent **study**[6] says that LFP in agriculture is very low but it employs over half the labour force. In contrast, financial and brokerage services are the most productive sector, in the economy, but employ a tiny share of the labour force.

Labour Productivity & its Reallocation

IMF (2006) suggests that a significant portion of China's increase in TFP has come as workers migrate from low-productivity sectors like agriculture to high-productivity sectors like manufacturing. What lies ahead for India? That so many continue to be dependent on agriculture is one reason that the government has focused on improving productivity in agriculture, even while attempting to support incomes of both farmers and workers through various programmes. Agricultural productivity remains low probably because too many agricultural workers work with relatively fixed and limited amounts of productive assets i.e., land and capital (irrigation, technology, tractors, machinery, and the like). One way to increase labour productivity, therefore, is to increase investment (and thus capital per employee) across all sectors, including agriculture[7].

An equally effective way of increasing labor productivity might be to increase TFP by moving some of those dependent on low-productivity agriculture to higher-productivity jobs in industry or services. This would also allow those who remain in agriculture to farm larger, more viable plots, employing more mechanised equipment to improve labour productivity. Clearly, more investment in worker-receiving sectors will be needed to keep up the capital per employee, but the typically greater TFP in those sectors will also mean much greater output per capita. Continuing reallocation of workers out of low-productivity sectors into higher-productivity sectors is akin to increasing TFP and can therefore be a growth engine[8].

What has been the situation of **workers' reallocation in India**? By plotting sectoral shares of employment and shares of value added in the years since takeoff the following situation has been shown by the **World Bank** *(World Development Indicators, July 2012)*:

Situation in ***Agriculture*** sector –

- India certainly has a bigger share of employment in agriculture today than the other Asian countries, but perhaps only because it has not had as many years since takeoff.
- Employment share and value added share in agriculture in India is coming down at a similar pace as in the other Asian economies (though Korea seems to have a lower share of people in agriculture).
- Extrapolating into the future, if India followed China's or Indonesia's path, about a 10 percentage point share of overall employment would move out of agriculture in the next 10 years, bringing the share of employment in agriculture down to about 40 per cent.

In sector ***Industry***, greater differences are seen –

- While the growth in India's share of employment in industry seems to be on par with the growth of other Asian economies at similar stages (with the exception of Korea), the surprising fact is that India's share of value added in industry has not grown to keep pace with its share of employment,basically, it has fallen.
- Contrast this picture with China's where the share of value added in industry has always been very high relative to its share of employment, or Indonesia's and Korea's where the share of value added has kept increasing as the share of employment has increased (e.g. for Indonesia) or even decreased (e.g for Korea).
- The alarming conclusion is that while workers are being added to industry in India, the productivity of the jobs they are going into has not been high. In part, this is because the data we work with treats low-productivity construction as a part of industry, and the booming construction sector has accounted for a large share of the jobs created in industry.
- However, an additional problem is that few of the jobs in industry are formal or being created by the comparatively more productive large firms.

The ***Services*** sector show another typical trait-

- While the share of employment in services has been growing very slowly, the share of value added is significantly higher than in other Asian economies.
- China has a similar share of employment in services at a similar time from takeoff even though its share of value added is much lower.
- A big factor in India's larger services share is that services started out at the time of take-off with a much larger share, but growth has also been strong.

Several finer points suggested by these sectoralpictures across countries :

- Unlike the conventional wisdom, India does not have more people in agriculture than other Asian countries at similar stages of development and the share of workers dependent on agriculture has been shrinking at a similar pace.
- However, the pace of shrinkage is set to increase if India is to follow the trajectory of these other countries.
- One problem is that while industry is creating jobs, these have been relatively low-productivity jobs. As a result, per capita income in India has not benefited as much from inter-sectoral migration of workers out of agriculture as other Asian countries have.
- A second problem is that the high-productivity services sector is not able to create employment commensurate with its growth in value added.

Chances of Missing Jobs

There is a clear transition of workers out of agriculture if we follow the path of other Asian countries. In addition, the demographic dividend will ensure more workers joining the labour force. How many workers will industry and services have to absorb in the next decade? How many will they absorb if they continue creating jobs as they have in the past? Could the demographic dividend turn into a demographic curse as some have argued? These questions may be answered taking clues from World Bank's *World Development Indicators-2012* and UN Population Division's *Revision of World*

Population Prospects-2010:

i. Assuming that employment in industry and services will grow during 2010-20 at the same rate as during the previous decade the share of employment in agriculture will fall to 40 per cent by 2020 (the same level as that of China in 2010). Population in the working age group will grow based on projections by the UN Population Division.

ii. Assuming the labour force participation rate and the unemployment rate to be unchanged at 2010 levels, 2.8 million jobs will be missing by 2020.

iii. To put this in perspective, this will only be 0.5 per cent of the labour force. While any shortfall in jobs is problematic, there does not seem an immediate cause for alarm.

There are a large number of assumptions which go into this estimate. For instance, labour force participation is pegged at the 56 per cent rate, the same as in 2010. If instead, more women enter the labour force, reversing the declining trend since 2000, the labour force participation rate could plausibly increase to 58 per cent by 2020. This is lower than the 60 per cent rate in 2000, but even with this conservative assumption, the number of missing jobs increases to 16.7 million, roughly six times that in the baseline scenario, and 3.7 per cent of overall employment in 2010. Finally, if the official unemployment is projected to decrease, say by 2 percentage points, over the next decade, again that would imply the need to employ a larger number of workers. The number of *missing jobs* in 2020 under this higher expected employment scenario is estimated at 11.8 million or four times that in the baseline scenario.

The back-of-the-envelope calculations done above should be taken as just starting point for more careful investigation. While a simple extrapolation of existing trends suggests India can absorb the labour exiting agriculture even if exits increase to the level experienced by China, there is no room for complacency. Minor changes in assumptions lead to tens of millions of additional jobs needed. So even while policymakers focus on making jobs more productive, India also needs more jobs than suggested by current trends so as to have a sufficient buffer.

REASONS BEHIND LESS CREATIVE JOBS

India's policies have created such a situation that too many small firms stay small and unproductive and are not allowed graceful close down. Too many large profitable firms/bisinesses prefer relying on temporary contract labour and machines than on training workers for longer-term jobs. We may visit the problem through two routes:

i. Impediments to Business Growth

ii. Labour Regulations

I. IMPEDIMENTS TO BUSINESS GROWTH

As a group, it is estimated that micro, small, and medium enterprises (MSMEs)[9] employ 81 million people in 36 million units across the country.[10] Yet, many of these firms are unable to grow and/or even shut down. As per a recent study[11], as compared to surviving small firms in the United States

which grow spectacularly, surviving small firms in Mexico grow moderately, while surviving small firms in India shrink. Productivity is commensurately lower in India. Indeed, within the MSME group, there is a strong concentration of small enterprises and near non-existence of medium enterprises. And that is the real challenge of the MSME sector—to be able to not just start up, but also continue to grow, thereby becoming a source of sustainable jobs and value creation.

Too many firms in India stay small, unregistered, unincorporated, largely informal, or in the unorganised sector because they can avoid regulations and taxes. These firms have little incentive to invest in upgrading skills of largely temporary workers or in investing in capital equipment that could bring them into the tax net, so their productivity stays low. Low productivity gives them little incentive to grow, completing the vicious circle. These firms face some of the key challenges while starting up and at every level of growth.

Regulatory Environment

The regulatory environment plays an important role in the lifecycle (birth, growth, and death) of MSMEs. We may cite few glaring comparative examples from some sources:

1. As per the **World Bank's** *'Doing Business: Measuring Business Regulations', 2013'*–
    - India ranks 132 out of 185 countries in ease of doing business,
    - Starting a business where India ranks 173, takes about 12 procedures, 27 days, and a paid up capital of 140 per cent of per capita income.
    - By contrast, it takes only 7 procedures, 19 days, and 18 per cent of per capita income on average for our neighbours in South Asia.
    - After getting done with the ***initial procedures***, entrepreneurs have to obtain a number of clearances when applying for building/occupancy permits and utility connections. These require separate visits to various authorities whose employees often inspect the site.
    - It takes as long as 1.5 months to obtain an electricity connection in 7 out of the 17 benchmarked Indian cities. Many processes especially at state level remain complex, forcing companies to hire a consultant, thereby adding to the costs.
2. An easier ***process of exit*** is needed for the MSME, which can quicken and simplify the process of resolving the claims of workers and financiers so that the assets of the failed firm can be put to better use. According to *World Bank's 'Doing Business in India, 2009'* –
    - Across 17 Indian cities, the insolvency process takes on average 7.9 years, costs 8.6 per cent of the estate value (mostly due to attorney fees, newspaper publication costs, liquidator's fees, and preservation costs), and the recovery rate is only 13.7 per cent.
    - The process is slower even than in other South Asian countries where, in the same year, it took on average five years and creditors could expect to recover on average 19.9 per cent.
    - Low asset recovery in failed firms feeds into lower levels of financing for Indian MSMEs.

The government has tried to compensate for some of these impediments by offering MSMEs incentives and concessions. But schemes and interventions based on tightly defined classifications

create an incentive structure that might prevent firms from growing. Service tax exemptions for firms with less than Rs 10 lakh revenue and exemption from central excise duty for firms with an annual turnover of less than Rs 1.5 crore are examples of these schemes. The jump from 'small' to 'medium' enterprise especially entails loss of several perks.

3. However, there are, also many good practices and regulations strewn over different cities of India, which, if standardised and adopted across the country, can improve the business climate enormously. The *World Bank's 'Doing Business in India, 2009'* has shown that if a hypothetical city called 'Indiana' were to adopt best practices found in several benchmarked cities (e.g. lowering number of procedures to start business to Patna levels, days to start a business to Mumbai levels, procedures around construction permits to Ahmedabad levels, days to enforce a contract to Guwahati levels, and recovery rate for closing a business to Hyderabad levels), it would rank a much improved 67 out of the 181 economies measured.

Difficult Funding

Indian banks and financial institutions are wary of lending to MSMEs because they lack adequate credit histories or collateral. A cluster-centric approach is one way of addressing this because it reduces transactions costs for the lender, while repeated interactions for a lender with cluster members increases the scope for building trust. While there have been efforts to facilitate these, their coverage is still small. Schemes such as credit guarantees by the Small Industry Development Board of India (SIDBI) have been useful, but there are gaps.

The presence of *Angel investors*, *venture capital funds*, and *impact investors* are still at a nascent stage and small compared to global peers. Most of these investments are biased towards services, especially technology and e-commerce. Government funds (through grants and seed funding programmes such as Technopreneur Promotion Programme and Technology Development Board) are often available after extensive paperwork and slow processing. Moreover, the experience from other countries is that new venture finance is often an activity better left to the private sector, with the government facilitating the way or piggy-backing on private funding rather than actually taking the lead.

To the extent large banks are concerned, with remote central offices they tend to have bureaucratic procedures for loan approvals, and limit discretionary authority for branch officers. As a result, small and medium enterprises, which tend to have short and largely informal track records, find it hard to fulfil the norms for obtaining credit.[12] Moreover, conversations with bankers and business people suggest that large banks exert less effort in trying to help a small troubled firm than they would a larger client. As a result, in countries with more varied banking systems, small firms tend to migrate to smaller banks for assistance.[13] Better funding to MSMEs can happen with the presence of more small local banks in India.

A vibrant *corporate bond market* could serve more in this scenario. Even then the MSMEs will not be able to issue bonds, but as large firms will migrate to the 'bond route' (as they are typically cheaper) it will make space on the bank balance sheets for MSME loans.

Lack of Quality Infrastructure

The lack of quality infrastructure (roads, utilities, real estate, logistics) increases transaction costs disproportionately for MSMEs which typically cannot create customised alternatives such as access roads and captive power plants which larger firms can. Absence of this supporting infrastructure causes *greater cash burn* and distraction of management from core business operations. One constraint in creating infrastructure or setting up businesses is **land acquisition**. A number of reforms are needed or are on the anvil (see the next sub-title *'Land Reforms'*) to ensure that land is less of an impediment to growth.

Land Reforms

Land is probably the single most valuable asset in the country today. Not only could greater liquidity for land allow more resources to be redeployed efficiently in agriculture, it could ease the way for land-utilising businesses to set up. Perhaps as important, it could allow land to serve as collateral for credit. Three important steps are needed regarding it[14]:

i. to map land carefully and assign conclusive title,

ii. to facilitate land leasing, and

iii. to create a fair but speedy process of land acquisition for public purposes.

The National Land Records Modernisation Programme (NLRMP), started in 2008, aims at updating and digitising land records by the end of the Twelfth Plan. Eventually, the intent is to move from *presumptive title* (where registration of a title does not imply the owner's title is legally valid) to *conclusive title* (where it does). Important points related to this process may be summarised as follows:

a. Digitisation will help enormously in lowering the costs of land transactions, while conclusive title will eliminate legal uncertainty and the need to use the government as an intermediary for acquiring land so as to 'cleanse' title.

b. Given the importance of this programme, its rollout in various states needs to be accelerated. Easier and quicker land transactions will especially help small and medium enterprises that do not have the legal support or the management capacity that large enterprises have.

c. Prohibitory *land leasing norms* raises the cost to rural-urban migration as villagers are unable to lease their land, and often have to leave the land untilled or leave a family member behind to work the land. Lifting these restrictions can help the landless (or more efficient landowners) get land from those who migrate, even while it will allow landowners with education and skills to move to industry or services.

d. Compulsory registration of leaseholds and of the owner's title would provide tenants and landowners protection.

e. Of course, for such a leasing market to take off, owners should be confident that longterm tenancy would not lead to their losing ownership. With a vibrant leasing market, and clear title, there should be little reason for not strengthening ownership rights.

f. For large projects with a public purpose – such as the proposed National Industrial and Manufacturing Zones, which will facilitate the setting up of small and medium enterprises, large-scale land acquisition may be necessary.

g. Given that the people currently living on the identified land will suffer significant costs including the loss of property and livelihoods, a balance has to be drawn between the need for economic growth and the costs imposed on the displaced.

h. The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Bill 2011, currently before Parliament, attempts to draw such a balance. As experience is gained with large-scale land acquisition, the institutions set up by the bill can be fine-tuned to achieve its aims.

i. Finally, encouragement needs to be given to land readjustment schemes, where when an area is identified for development, owners participate by giving up some of their land for infrastructure creation, but get back the rest, with the benefit that its value is enhanced by the infrastructure. Small and medium enterprise clusters can benefit especially from such schemes.

j. Given that large-scale land acquisition is still at a nascent stage, central schemes should allow room for states to experiment and should be modified, the light of the experince of states.

This measure will also create a conducive environment for 'corporate' and 'contract' farming which is not picking up due to absence of a proper 'land-leasing' norm in the agriculture sector. But then the 'labour law' reform will also be needed which will benefit the business and industries, too.

The major **non-labour impediments** for a small business to become formal and grow large, as well as some steps the government is taking have been highlighted here, there is evidence that these constraints affect industrial performance. After classifying industries according to their intensity of use of infrastructure, or dependence on external finance, it has been found out[15]:

i. that post delicensing, industries more dependent on infrastructure, grew less as compared to industries which are not as dependent on infrastructure; and

ii. the gain in manufacturing-sector output in these industries has been especially small in states with inferior infrastructure.

iii. that industries more dependent on external finance have witnessed slower growth as opposed to those less dependent on external finance, and have fared much worse in terms of new factories, employment generation, as well as new investment.

Therefore, there is need to take steps for improving infrastructure, access to finance, as well as the overall business environment. It is hoped that massive infrastructure projects like the ***DMIC*** (Delhi-Mumbai Industrial Corridor) will provide relatively light regulation, and heavy infrastructure, where businesses have easy access to the land they need and workers can live in a safe healthy township (see the next sub-title *'The DMIC'*).

The DMIC

Conceived by the Ministry of Economy, Trade and Industry (METI) of Japan and the Ministry of Commerce and Industry (MoCI) of India, the DMIC seen as an example of India's 'Integrated Approach to Industrial Growth and Development'. This is being developed by the Government of India with a view to using the high-capacity western Dedicated Freight Corridor as a backbone **for creating** a global manufacturing and investment destination. The project seeks to develop a series of

futuristic infrastructure-endowed smart industrial cities that can compete with the best international manufacturing and industrial regions. The *master plan* has a vision for 24 manufacturing cities. Potential production sectors include general manufacturing, IT/ITES components, electronics, agro and food processing, heavy engineering, pharmaceuticals, biotechnology, and services. Total investment is pegged at $90 billion. ***Special features***[16] of the the Project are as given below –

Possible Socio-economic Impact: Its Influence Area of 436,486 sq. km is about 13.8 per cent of India's geographical area. It extends over seven states and two union territories, viz. Delhi, Uttar Pradesh, Haryana, Rajasthan, Madhya Pradesh, Gujarat, Maharashtra, Daman and Diu, and Dadra and Nagar Haveli. Around 17 per cent of the country's total population will be affected. The project goals are to double employment potential in 7 years, triple industrial output in sector on a sustained basis over next three years.

Urban Governance: Its innovative urban governance framework corporatises the urbanisation process. The central government will create a corpus fund, the 'DMIC Project Implementation Revolving Fund', as a trust administered by a board of trustees. The fund will contribute debt and equity to the SPVs (Special Purpose Vehicles) on a case-by-case basis. Land will be made available by the state government. The city SPVs will be vested with the responsibilities of planning and development and the power to levy user fees. The SPVs are to be companies under the Companies Act. The valuation increases from urbanisation and development will accrue to the city-level SPVs, and will be reinvested in the cities. The initial construction of the cities will be done through project managers with global experience, who will control, monitor, review, and supervise the detailed engineering.

Financing: Its trunk (basic) infrastructure is unlikely to be commercially viable that is why it would require government funding. Such internal infrastructure projects include land improvement, road works, earthworks, sewerage, storm water drainage, flood management, and solid waste management. Once such infrastructure is in place, the subsequent additions to the cities will be commercially viable and can be implemented through public private partnerships (PPPs). For major infrastructure activities such as power plants, integrated townships, and highways, PPP projects are planned. Various sources of funding have been planned as multilateral, bilateral, and domestic government.

Physical Infrastructure: The Multi-modal High Axle Load Dedicated Freight Corridor (DFC), 'a high-capacity railway system', is at the heart of the infrastructure. It will cover 1483 km and will have nine junction stations along which other railroad networks will connect allowing the system to extend its reach across a wide area. Other infrastructure plans include logistic hubs, feeder roads, power generation facilities, up-gradation of existing ports and airports, developing greenfield ports, environment protection mechanisms, and social infrastructure.

Industrial Infrastructure: It seeks to upgrade existing industrial clusters and also develop new industrial facilities – to be developed on the concept of 'node-based development', based on Investment Regions (IRs) and Industrial Areas (IAs). These are proposed as self-sustaining industrial townships with world-class infrastructure including domestic/international air connectivity, reliable power, and competitive business environment. IRs will have a minimum area of 200 sq. km and IAs 100 sq. km. In all 24 manufacturing cities (IRs and IAs) are planned. Seven major manufacturing cities are being planned for the first phase. These will serve as the key nodes for overall growth and development.

Power Infrastructure: Power for the industrial and residential zones is an essential requirement. The provision of world class power infrastructure will require 'twenty-four hour' good quality supply. The major power inputs will come from six gas-based projects of around 1000-1200MW each. Other power options include the use of renewable energy sources integrated through a smart grid.

Skill Development: The skill-building strategy underlying the DMIC is based on a 'hub-and-spoke' model in which one Skill Development Centre in every state with subsidiary institutions linked to it. Curricula will be based on the types of industries located in the region and identified regional strengths.

Land Acquisition: Land acquisition appears to be a major challenge. Different state governments are adopting diverse approaches for dealing with the issue. Gujarat has a 'land-pooling' model whereby 50 per cent of the land is acquired while the remaining 50 per cent is left with the original owners giving them a stake in the upsides generated by land monetisation. Maharashtra allows for 'negotiated purchase' involving various stakeholders. In Haryana and Rajasthan, trunk and industrial infrastructure are created by the state governments but private developers directly participate in the other activities. The value increase is captured by the states through development fees. Furthermore, in the initial DMIC master-planning process, the attempt was made to identify large, easy-to-acquire land parcels that were either barren or government owned.

Environmental Clearances: The master-planning process was put forward for a general Terms of Reference clearance, which has already been obtained. This has reduced the compliance load for individual project clearances. The individual projects will now need to get their draft impact assessments cleared by the respective state pollution control authorities.

Water Management: As the corridor passes through relatively arid parts of the country, the industrial hubs are to have integrated water resource management plans drawing upon lessons from countries such as Singapore. It is proposed to make each manufacturing city self-reliant and sustainable in terms of its water requirements. Recycling is a major strategy in all the industrial nodes.

Steps to Improve Business Climate

The business climate of India has not been conducive enough for the arrival, growth and winding-up of the MSMEs. By effecting some regulatory changes, the business climate for MSMEs can be improved in a great way which they may be summarised as follows[17] :

Common policy: There are a vast number of business regulations that often overlap and sometimes contradict each other. A common policy and an institutional architecture overseeing all business regulations will help consolidate and enact changes.

Facilitation: Establishing independent facilitation and coordination agencies as PPP service companies with mandate from the state government, staffed with specialists and responsible for getting work done through various departments for starting up and running of businesses. These agencies will also help arrange services such as financing, finding raw material suppliers, and marketing products. They will charge a fee for some of the services provided, and be financially selfsufficient.

Simplification of Registrations: Creating a one-stop online registration system for time-bound registrations for starting a business. The applicant will need to file a single application on the

website, with the required information being picked up by each government department. Over time, this process can be extended to other activities such as trading across borders and paying taxes. This will require detailed mapping exercises and setting up of a 'best practices' framework.

Easier Compliance after Growth: Enabling compliance ratings of MSMEs (through ISO-like common standards) and allow easier compliance norms to firms with higher ratings. Easier norms can take the form of simpler procedures (such as self-certification) across government departments. For instance, a company with a good history of tax compliance should be treated as a good citizen when it deals with the pollution control board. Over time, high compliance ratings could also act as a signal to financiers and enable easier access to credit.

Easy Exit: The arduous process of exit for unsuccessful companies needs to be made simpler, faster, and cheaper.

Transforming Employment Exchanges: Transforming the 1,000-odd employment exchanges across states into career centres offering counselling, assessments, apprenticeships, training, and jobs.

Improving Statutory Pre-emptions: Currently for low wage workers in formal employment, the plethora of statutory pre-emptions, especially for provident fund and health insurance, can lead to very low net salary and act as disincentive to formal employment. The value and benefits received from these pre-emptions can be improved by encouraging competition between different pension and health schemes.

Reducing Attractiveness of Staying Small: Growing bigger is unattractive in India because some of the benefits targeted at MSMEs are withdrawn while some new regulations and obligations come upon them. Innovative approaches are needed for giving MSMEs the incentive to grow. For instance, new regulations could be kept in abeyance for a period after the MSME crosses the size threshold that would require it to meet the regulation.

II. LABOUR REGULATIONS

India has a number of labour practices that, economists have argued, further impede the creation of productive jobs in the largescale organised sector. There exists considerable variation in hiring practices across firms of different sizes in India. A recent study[18] finds that the job creation rate is much bigger for small firms than for large ones; on the other hand the job destruction rate is higher in large firms, with the result that the net employment rate in large firms is negative and strikingly smaller than in small firms.

In the same way, organised industry creates few jobs compared to unorganised industry (which is dominated by small firms). Growth in unorganised industry jobs in 2009-10 is primarily explained by a dramatic growth in construction. Based on data from National Sample Survey Organisation (NSSO) surveys, employment in construction increased by 70 per cent between 2004 and 2009. One recent development is the significant pickup in growth of the organised industry sector jobs in 2009-10. However, two points may be of note. First, this growth is characterised by adding mostly to 'informal' jobs within the formal sector with little increase in productivity. Second, despite the recent pickup in organised-sector job growth, unorganised-sector employment still constitutes more than 95 per cent of overall industry employment; specifically within manufacturing, unorganised-sector

employment comprises 70 per cent of overall employment.

Why more jobs are not being created by India's large organised manufacturing? There are several possible explanations. First, strict labour laws may have hindered the growth of organised large-scale manufacturing. India, the employment protection legislation (EPL) laws are stricter than in all but two OECD countries. However, very few workers are actually covered by these laws. Indeed, India may suffer the consequences of strong worker protection (low flexibility for employers and strong reluctance to offer workers formal jobs) without giving most workers the benefits. Although the direct impact of India's labour regulations has been a subject of intense debate, there is a substantial body of evidence which suggests that rigid labour regulations have played a significant role in explaining low organised manufacturing output and employment and high informal manufacturing output.

However, some economists dispute the evidence that establishes the importance of labour regulations in determining economic outcomes. In India's case, one of the first and most frequently cited studies on the topic[19] has come under extensive criticism[20]. While more work has been done that addresses some of these criticisms, the evidence on the effects of labour regulations outside of India is also mixed. As per the World Bank,[21] 'A careful review of the actual effects of labour policies in developing countries yields a mixed picture. Most studies find that impacts are more modest than the intensity of the debate would suggest.' If labour laws really constrain firms, they would respond in predictable ways:

i. Relying more on capital instead of labour
ii. Resorting to informal arrangements/limiting their scale in order to remain outside of the formal sector altogether, and/or
iii. Hiring contractual labor

The increased use of capital-intensive techniques is reflected in a steeply rising capital/labour ratio for the organized economy.[22] This raises the obvious question whether it is justifiable for a relatively labour abundant country like India with low wages to be increasingly resorting to more capital-intensive technology. Of course, as we have argued earlier, countries would use more capital per worker as they get richer, but the capital intensity is higher and has increased at a much faster rate for large firms than for small firms in India, even while they have created fewer jobs.[23]

Firms would also resort to informality if labour laws were overly constraining (as has been argued earlier in this chapter). The extent of informality in India stands out relative to countries at similar levels of development (discussed in the next sub-title *'Informality of Employment in India'*). Roughly 85 per cent of the workforce in India is engaged in the informal sector all of which are unincorporated enterprises operated on a proprietary or partnership basis and with less than 10 employees. The prevalence of informal employment – workers in either the informal sector or in the formal sector but lacking employment or social security benefits is even higher; 95 per cent of jobs are informal and 80 per cent of non-agriculture wage workers work without a contract.

There is **advantage of formal employment** via contracts for worker training and learning, especially if contracts have a significant probability of being rolled over into the long term. Experience is important for skill development. With a paucity of technical/vocational training institutions (say like the *German model*) in India, 'on-the-job learning' is one of the easiest and most viable models of

human capital accumulation. Employment that is likely to endure provides incentives to the firm for nurturing skill building and to the worker for developing skills. These contracts necessitate *backloading* of pay and incentives (compensation increases with experience) so that workers do not avail of the training and leave. In contrast, informal and temporary contracts are in fact flat and sometimes even *frontloaded*, absolutely the inverse of the desired architecture. Long-lasting employment does not mean tenure for life, which is the other extreme of the contract space commonly found in India. Permanent employment not only limits firm flexibility, it also reduces some workers' incentives to learn or exercise effort. An intermediate structure that exists in most countries is contracts that allow termination in situations of firm distress or for poor worker performance, but with carefully designed and effective redressal mechanisms if the employee is fired without cause, as well as compensation for severance and unemployment benefits.

Whatever be the causes, the fact is that India is not creating enough productive jobs. Moreover, India has the *dubious distinction* of having some of the most comprehensive labour laws in the world, even while having one of the largest fractions of the working population unprotected. Not only do informal workers have lower productivity and earn less, but they are also more vulnerable to violations of basic workers' rights such as reasonable working conditions and safety at work. It may be the stringent protection that is afforded by existing regulations that is responsible for both the 'paucity of good jobs' as well as the inadequate protection that most workers have. In India, reforms are typically implemented only after they have been subject to a lot of debate and after some sort of ***political consensus*** is reached on them. It is therefore imperative that consensus building on **labour market reforms** should start soon. India needs many more firms in the formal sector, especially firms that continue growing and creating productive jobs. India may take some ideas from Mauritius as how did it undertake reforms that improved employment.

It may take time to build political consensus for fundamental reforms. In the meantime, states could be allowed more flexibility to experiment without coming into conflict with central statutes. As best practices evolve, success in job growth will resolve theoretical debates more easily than a thousand papers. If indeed, rigid labour laws are determined to be the key constraining factor in the creation of productive jobs. Win-win reforms are easily available. Existing permanent workers can continue till retirement with their privileges left untouched. The remaining workers could be encouraged to move into contractual employment that can be terminated, but which gives the worker some protections including severance pay, unemployment insurance, and the right to reverse unfair dismissal through appeal.

In the meantime, the government should continue to create a minimum safety net for informal workers (in the informal sector and in informal work arrangements in the formal sector) by, for example, extending the reach of national-level schemes such as the RSBY (Rashtriya Swasthya Bima Yojana) and the NPS (New Pension Scheme) and introducing *unemployment insurance schemes* (e.g. Supplementary Unemployment Benefits Fund to be created by automotive companies).

INFORMALITY OF EMPLOYMENT IN INDIA

The *extent, causes* and *consequences* of informality in India's employment can be seen by the following way:

i. Extent of Informality

India has witnessed impressive economic growth over the past 20 years, but despite of it, the vast majority of Indian workers continue to toil in informal employment.

- Roughly 85 per cent of the workforce is engaged in the *informal sector*; even after excluding the agricultural sector, the share of the workforce in the informal sector remains at 70 per cent.[24] The prevalence of *informal employment* workers in either the informal or formal sector who lack employment or social security benefits is even higher.
- While precise estimates of the extent of informal work arrangements are hard to come by, a detailed study by the National Statistical Commission reveals that as of 2004-05, 95 per cent of jobs are informal and these are not limited to the informal sector, even in the public sector, 33 per cent of all jobs in India are informal.[25]
- Among wage employees outside of agriculture, more than three-quarters have no written contract, 70 per cent are not eligible for any paid leave, and 74 per cent are not covered by social security benefits. Along all of these measures of informality, India saw an uptick over time.[26]
- "While high levels of informality are not uncommon in South Asia, India (along with the rest of the region) stands out from an international perspective. Using lack of pension coverage as a proxy for informal employment, 91 per cent of the labour force in South Asia is informal, surpassed only by Africa. Compared to countries at a similar level of development, India's very low usage of written contracts for its non-agricultural employees, 80 per cent of whom work without a contract, also stands out. This figure is higher than for, for example, China, Pakistan, Ghana, and South Africa. This is despite the fact that India's share of employment in the informal sector is roughly in line with that of its peers and confirms the significant prevalence of informal arrangements within the formal sector." [27]

ii. Causes of Informality

Informal employment results both from workers being excluded from formal jobs and from workers or firms voluntarily opting out of formal employment.

- The 'exclusion' view of informality emphasises the *dual nature* of labour markets, in which a highly productive formal sector coexists with a subsistence informal sector, which absorbs excess labour.
- It has been found out through evidence that constraints to the expansion of the formal sector model (such as insufficient capital accumulation and natural resources)[28] or overly burdensome costs of registering[29] lead to persistent informal employment.
- As per the 'voluntary' view, firms and workers decide on whether to become formal by comparing the perceived costs of being formal with its perceived benefits. In this setting, labour institutions, taxation, and regulations primarily explain the prevalence of informal employment, by effectively increasing the costs of formality. At a cross-country level, countries with more burdensome entry regulations have larger informal sectors.[30] The labour laws of India may incline firms to go for informal arrangements, rely more on capital instead

of labour, or limit their scale in order to remain outside of the formal sector altogether. This issue has been discussed in the next sub-title *'Labour Laws as Impediments'*).

iii. Consequences of Informality

The high rate of informality in India is a drag on its economic development and a source of considerable inequity.

- Productivity differences between workers in the formal and informal sectors are large, suggesting that moving a worker from an informal to a formal firm would bring about sizeable gains from improved allocation of resources.
- Rough estimates suggest that an informal job in the formal sector has double the value added than an informal job in the informal sector. And importantly, the value added per worker in a formal job within the formal sector is almost ten times that in an informal job in the formal sector. Therefore, loosely speaking, the benefits of moving into contracts within the formal sector are likely to be substantial and significantly higher than the gains from moving an informal-sector worker into an informal job within the formal sector.[31]
- Besides earning less, informal workers are also more vulnerable to violations of basic human rights such as reasonable working conditions and safety at work. With little job security and limited access to safety nets, most of the informally employed remain extremely vulnerable to shocks such as illnesses and loss of income. This is why a strong correlation exists between informality and poverty in India.[32]
- From the point of view of firms, informal work arrangements bring benefits: lower price and greater flexibility in adjusting the quantity of labour in response to fluctuating demand. Yet, these benefits are partly offset by costs, such as low worker loyalty and inadequate incentive to invest in worker skill building. Moreover, any net benefits need to be weighed against the social costs to the workers and the economy as a whole.
- Finally, persistently high levels of informality come at a significant fiscal cost in terms of forgone fiscal revenue.[33] In 2004-05, the unorganised sector contributed roughly half of India's GDP[34] implying a significant expansion of the tax base if the informal sector were to join the formal economy. The high prevalence of informality also hampers the ability of economic policies to have direct and quick impact on the economy.

The Mauritian Miracle

While Mauritius was assuming self-rule from the British, two noted intellectuals (and to be **Nobel laureates**), James Meade (economics) and V.S. Naipaul (literature) prophesied a bleak future for this small island. In the 1960s, Mauritius was heavily dependent on one crop – *sugar* – was prone to 'terms-of-trade' shocks, and was undergoing rapid increase in population. What followed though was counter to their predictions. Between 1977 and 2006, real GDP grew by an average of 5.2 per cent per annum. Per capita GDP growth averaged 4.2 per cent versus 0.7 per cent for the rest of Africa. From 1970 to 2008, life expectancy increased from 62 to 73 and infant mortality dropped from 64 per 1000 births to 15.

What explains this performance? A leading factor in the first two decades of turn around is the creation and efficient management of the EPZs (Export Processing Zones). Some major characteristics of the 'Mauritius EPZ' were:

i. It was not a geographical zone – any firm could opt into the regulatory scheme.

ii. The main policies were – ease of inputs and materials imports, no restriction on repatriation of profits, a 10-year income tax holiday for foreign investors, a policy of centralized wage setting, and an implicit assurance that labour unrest would be minimized and wage increases moderate.[35]

iii. Firms were allowed to constantly adjust labour force through layoffs and realistic compensation packages and allowed greater flexibility in work hours.

iv. It had relaxed laws so that women could participate to a greater extent.

These structural transition had a very positive and quicker impact on the economy. The first stage was motivated by a productive structural shift and ensuring full employment. By 1990, about one-third of the labour force on the island, 90,000 people, was employed in the EPZs. Jobs added in the EPZs accounted for two-thirds of the total increase in employment between 1970 and 1990. Increased per capita incomes from this transition eventually fuelled more human capital build-up, allowing further diversification into services.

Labour Laws as Impediment

A rapid expansion of the manufacturing sector has been a key element of the growth experience of successful developing countries, especially labour-abundant ones. In this context, the Indian manufacturing sector exhibits many peculiarities:

i. It contributes (also documented earlier in the chapter) a rather small and stagnant share to GDP;

ii. Its composition is more skewed towards skill and capital intensive activities compared to countries at similar levels of development;[36]

iii. Only a small share of employment in manufacturing is in organised manufacturing. The unorganised manufacturing sector accounted for almost 70 per cent of total manufacturing employment in 2009-10[37];

iv. Employment is heavily concentrated in small firms. The degree of concentration is much higher than in other Asian countries. For example, the share of micro and small enterprises in manufacturing employment is 84 per cent for India versus 27.5 per cent for Malaysia and 24.8 per cent for China.

These characteristics of Indian manufacturing are quite puzzling in that product market reforms since the early 1990s, including dramatic trade liberalisation and virtual abolishment of the industrial licensing regime, have been primarily focused on removing various constraints on the manufacturing sector. How then does one explain the peculiarities of the Indian manufacturing sector? Several theories have been put forward to explain this puzzle, ranging from strict labour laws that have hindered growth, especially of labour-intensive industries, infrastructure bottlenecks that have prevented industries from taking advantage of reforms, and credit constraints due to weaknesses in the

financial sector which may be holding back small and medium sized firms from expanding. India's labour regulations have been criticised on many grounds including sheer size and scope , their complexity, and inconsistencies across regulations:

i. There are 45 different national and state level labour legislations in India.[38] The labour laws apply only to the organised sector.
ii. As the size of a factory grows, it increasingly becomes subject to more legislation. A few specific pieces of the legislation are particularly constraining.
iii. According to Chapter VB of the **IDA** (Industrial Disputes Act), it is necessary for firms employing more than 100 workers to obtain the permission of state governments in order to retrench or lay off workers.
iv. While the IDA does not prohibit retrenchment, states have often been unwilling to grant permission. Section 9A of the IDA lays out the procedures that must be followed by employers before changing the terms and conditions of work, which introduces additional rigidities for firms in using their existing workers effectively.[39] In particular, worker consent is required in order to modify job descriptions or move workers from one plant to another in response to changing market conditions.

How do these regulations affect the manufacturing sector quantitatively?

Evidences[40] show that industrial performance has been weaker in states with pro-worker labour laws. There have also been several recent studies that establish the importance of labour regulations.[41] Estimates using plant-level data suggest that firms in labour intensive industries and in states with flexible labour laws have 14 per cent higher TFP than their counterparts in states with more stringent labour laws. Moreover, the impact of delicensing has been highly uneven across industries within India's organised manufacturing sector. In particular, labour-intensive industries have experienced smaller gains from reforms. In addition, states with relatively inflexible labour regulations have experienced slower growth of labour-intensive industries and employment. Further, the difference in the performance of labour-intensive industries in states with flexible labour laws and states with inflexible labour laws has increased over time. Labour laws may also be an important factor responsible for the skewed distribution of size in Indian industries. Firms in states with more inflexible labour regulations tend to be smaller, especially in the labour-intensive sub sectors of manufacturing.

A contrarian view is that Indian businesses have learnt to get around the laws by hiring contractual labour, outsourcing non-core activities, etc; it is thus argued that labour regulations are not a binding constraint to industrial performance and employment growth. Indeed, in surveys of firms, businesses do not list labour laws among the top constraining factors. One way of reconciling this response with the systematic empirical evidence discussed here is that firms have learned to adapt to the labour laws by either not hiring permanent workers or by staying below the threshold of these laws and therefore, they do not see them as a constraint. A study[42] points out that the counterfactual of whether labour laws would constrain firms that would emerge in the absence of strict labour laws cannot be captured in the surveys. Moreover, the adverse consequences of the labour laws can be inferred from the low rate of job creation in the formal sector, low productivity in the informal sector, and small firm size, especially in labour-intensive industries and states with more inflexible labour laws.

SERVICES NOT CREATING ENOUGH JOBS

While the share of employment in services in India was relatively high at take-off, its growth has since then been slow (as have been discussed earlier in this chapter). At the same time, the share in value added, which was high at take-off, has continued to rise quickly. This implies that *while productivity in the sector has been high, the services sector is not creating many jobs* this is the opposite of the problem with the industry.

In the process of business creation, there may some common impediments to services and industry both, for example, regulatory hurdles and access to funding and infrastructure. Labour regulations are also likely to constrain creation of jobs in services. For example, 27 per cent of retail stores in India report labour regulations as a problem for their businesses.[43]

But what stands out for the services sector is the importance of **education** and **skilling**. Suitable higher education is important for high-end services such as IT, software development, and finance. Mid-level services such as retail trade, hotels, and restaurant services also require adequate skilling of the labour force. The 'formal apprenticeship' programme of the government, which places ***employers at the heart of education,*** can play a powerful role in imparting job-relevant skills and also retraining, preparing, and upgrading the labour force. In its current form, the Act and the Rules governing apprenticeships are outdated and rigid from both the perspective of employers and employees and they need to be amended (discussed in the next sub-title *'Need of Formal Apprenticeship'*).

Addressing both quality and quantity issues are the twin challenges in skill development and training so as to correct the mismatch between employers who do not get people with requisite skills and millions of job seekers who do not get employment. The National Skill Development Mission (NSDM) aims to impart employment-oriented vocational training to ***8 crore people over the next 5 years*** by working with state governments (through the State Skill Missions) and incorporating the private sector (through PPPs and for-profit vocational training) and NGOs. Basic education is also an important input for enhancing human capital. Recent government initiatives to expand access to quality primary education are important; however, more needs to be done (discussed under the forthcoming sub-title 'Improving Primary Education'), see Box 2.8).

NEED OF FORMAL APPRENTICESHIPS

In the process of achieving a quality manpower, experts have always emphasised the schemes which impart formal apprenticeships to the working population of a country. Though India has already such schemes put in place, but due to several reasons could not bring in the desired effects in the economy. As India aspires for higher demographic dividend, it is high time that India re-oriented and restructured the existing set of Acts and Rules governing the apprenticeships to bring in rational points, we may have a **three part** discussion on the issue.

1. The Importance of Apprenticeship

Equipping the labur force with productive skills lies at the heart of tapping the demographic dividend. Apprenticeships are an effective way of ensuring that entry-level workers have the skills required to join the formal workforce by 'learning on the job' and even 'earning while learning'. It has been amongst the oldest social institutions in India. However, it needs to be formalised and scaled up. In the current environment, India's educational system is overburdened by sheer demand for quality education. According to a recent study[44] by India's first vocational university, 80 per cent of India's higher education system of 2030 is yet to be built and is grappling with the *threefold problem* of cost, quality, and scale. This is compounded by the inability of much of the current education system to produce 'work-ready' labour. In fact, the **disconnect** between the formal educational system and requirements of the employers becomes even more acute in times of rapid structural and technological change. In such an environment, company-led apprenticeship programmes, that place employers at the heart of education, can play a powerful role in imparting job-relevant skills and also repairing, preparing, and upgrading the labour force. They can aid five important transitions that the labour force is currently making

i. from agriculture to non-agriculture,
ii. from rural to urban,
iii. from the unorganised sector to the organised,
iv. from school to work, and
v. from subsistence self-employment to wage employment.

Several countries have benefited greatly from focused programmes on skilling the workforce on the job, including Japan, US, UK, and Germany. Germany, in particular, has a well-known dual education system that combines classroom/online courses at a vocational school with workplace experience at a company. School authorities are responsible for the former while the company is responsible for the latter. More than 75 per cent of Germans below the age of 22 have attended an apprenticeship programme. Training apprentices also benefits corporates. The UK Task Force Report on Apprentices in 2005, demonstrated that the benefits of apprenticeships were numerous, including – i).increased productivity, ii). lower net costs of training (versus training non-apprentices), iii). greater staff retention, and iv). a more highly motivated workforce.

2. Things India Have

The apprenticeship programmes in India are governed by The Apprentice Act 1961 and the Apprenticeship Rules 1992. The organisational structure and rules and regulations overseeing it are complex and burdensome. The Ministry of Labour and Employment oversees 'trade apprentices' through six regional offices. The Ministry of Human Resource Development oversees 'graduate, technician, and technician (vocational) apprentices' through four boards located in different cities. There are strict norms on permissions, trades permitted, training duration, stipend levels, apprentice/employee ratio, and training facilities. It is onerous to create new apprenticeship positions, and there are several vacancies even in positions that have already been created. As a consequence, India only has under 3,00,000 formal apprentices.

To ensure that comparier do not hire cheap labour in guise of an apprenticeship programme, the regulatory norms were kept tighter. The need of the time is to develop set of provisions streamlining

regulation and incentivise corporates, while protecting the interest and well-being of apprentices.

3. Making it Work

The present rules and regulations overseeing apprenticeships need to be changed such that employers and prospective apprentices can choose each other freely by just requiring information on what will be learnt on the job and a minimum wage. Some recommendations including those from the 2009 **Planning Commission** taskforce are described below:

i. *Simpler Regulation:* A single window mechanism is needed to clear company applications for pan-India apprenticeship programmes. Currently, companies need to approach each state apprenticeship adviser separately. Partnerships between companies and industry federations should be facilitated by giving timely permissions.

ii. *Wider Reach:* Presently apprentices are only allowed in specified trades. Majority of graduates are not currently covered under 'Formal Apprenticeships'. In addition, the procedure to include new trades especially services, which are largely excluded, is complex and can take many months. A fully deregulated list is needed for apprenticeships to remain dynamic and in line with the changing needs of the workplace.

iii. *Flexibility to Companies:* At present many schemes are required to be unnecessarily long (up to four years), and have rigid requirements on 'worker to apprentice ratio'. Moreover, the penal provisions for companies, even for small violations of the rules, are very severe. Certain relaxation of rules can help give flexibility to companies. For example, the duration of apprenticeship training can be allowed to vary across trades and companies. Short-duration programmes (less than 12 months) can be freed from much of the oversight provided they pay minimum wages. Relaxing the rigid requirements on the ratio of apprentices to workers could also accelerate capacity creation.

iv. *Dual System of Training:* Partnerships between companies and educational institutions should be encouraged. Like the 'German model', corporates can be allowed to outsource theoretical training, and educational institutions can be allowed to outsource practical training.

v. *Active Exchanges:* There should be active exchanges and portals, matching prospective apprentices to employers.

WAY TO EVIDENCE-BASED BETTER POLICY

Educational investments contribute to aggregate economic growth. More than this, they enable citizens to broadly participate in the growth process through improved productivity, employment, and wages, and are therefore a critical component of the 'inclusive growth' agenda of the Government of India. The past decade has seen substantial increases in education investments under the Sarva Shiksha Abhiyan (SSA), and this additional spending has led to considerable progress in improving primary school access, infrastructure, pupil-teacher ratios, teacher salaries, and student enrollment. Nevertheless, student learning levels and trajectories are disturbingly low, with nationally representative studies showing that over 60 per cent of children aged 6-14 are unable to read at

second-grade level. Further, these figures have shown no sign of improving over time (and may even be deteriorating).[45]

The decade also saw a number of high-quality empirical studies on the causes and correlates of better learning outcomes based on large samples of data and careful attention paid to identification of causal relationships. This research has identified interventions/inputs that do not appear to contribute meaningfully to improved education outcomes, as well as interventions that are highly effective. In particular, the research over the past decade suggests that increasing inputs to primary education in a 'business-as-usual' way is unlikely to improve student learning meaningfully unless accompanied by significant changes in pedagogy and/or improvements in school governance. It is, therefore, imperative that *education policy shifts* its emphasis from simply providing more school inputs in a 'business-as-usual' way and focuses on improving 'education outcomes'.

School Inputs

Both administrative and survey data show considerable improvements in most input-based measures of schooling quality. But there is very little impact of these improvements in school facilities on learning outcomes. This is not to suggest that school infrastructure does not matter for improving learning outcomes (they may be necessary but not sufficient), but the results highlight that infrastructure by itself is unlikely to have a significant impact on improving learning levels and trajectories. Similarly, while there may be good social and humanitarian reasons for 'mid-day meal' programmes (including nutrition and child welfare), there is no evidence to suggest that they improve learning outcomes. Even more striking is the fact that no credible study on education in India has found any significant positive relationship between teachers possessing formal teacher training credentials and their effectiveness for improving student learning.

In the same way, there is no correlation between teacher salary and its effectiveness for improving student learning, and at best there are very modest positive effects of reducing pupil-teacher ratios on learning outcomes. As discussed further, these very stark findings most likely reflect *weaknesses in pedagogy* and *governance* which are key barriers in translating increased spending into better outcomes.

The results summarised so far can be quite discouraging. Fortunately, the news is not all bad, because the evidence of the past decade also points consistently to interventions that have been highly effective for improving learning outcomes, and are able to do so in much more cost-effective ways than the status-quo patterns of spending.

Pedagogy

The science of education, teaching and classroom instruction (pedagogy) is a key determinant which decides how schooling inputs translate into learning outcomes. Today, following the right kind of pedagogy has become particularly challenging in India as several millions of first-generation learners have joined a rapidly expanding national schooling system. In particular, standard curricula, textbooks, and teaching practices that may have been designed for a time when access to education was more limited, may not serve the purpose in the new circumstances prevailing today. The default pedagogy of 'completing the textbook', does not reflect the learning levels of children in the

classroom, as they always remain behind the textbook expects them to be. Evidences suggest that the 'business-as-usual' pedagogy – simply following the textbooks – can be improved with large positive impacts in early grades that target the child's current level of learning:

i. These positive results have been found consistently in programmes run by non-profit organisations in several locations (including UP, Bihar, Uttaranchal, Gujarat, Maharashtra, and Andhra Pradesh).
ii. The estimated impact of these interventions have been considerably high often exceeding the learning gains from a full year of schooling (their instructional time period is typically only a small fraction of the duration of the scheduled school year).
iii. These interventions are typically delivered by modestly paid community teachers, who mostly do not have formal teacher training.
iv. The supplemental remedial instruction programmes are highly cost effective and deliver significant learning gains at much lower costs than the large investments in standard schooling system.

Governance

Another explanation for the 'low correlation between increases in spending on educational inputs and improved learning outcomes' may be the *weak governance* of the education system and limited effort on the part of teachers and administrators to improve student learning levels:

i. The most striking symptom of weak governance is the high rate of teacher absence in government-run schools. While teacher absence rates were over 25 per cent across India in 2003, an all-India panel survey in 2010 that covered the same villages found that teacher absence in rural India was still around 24 per cent.
ii. The fiscal cost of teacher absence was estimated at around Rs 7,500 crore per year suggesting that governance challenges remain paramount.
iii. There is evidence that even modest improvements in governance can yield significant returns. Improving monitoring and supervision of schools is significantly correlated with reductions in teacher absence, and investing in improved governance by increasing the frequency of monitoring could yield an eight-to-tenfold return on investment in terms of reducing the fiscal cost of teacher absence.
iv. The importance of motivating teachers by rewarding good performance has also been pointed out by the evidences. Rigorous evaluations of carefully designed systems of teacher performance pay in Andhra Pradesh show substantial improvements in student learning in response to even very modest amounts of 'performance-linked pay' for teachers, that was typically not more than 3 per cent of annual pay.
v. Evidence from a long-term follow up shows that teacher performance pay was 15 to 20 more times more effective for raising student learning than reductions in pupil-teacher ratios.
vi. More broadly, these results suggest that the performance of front-line government employees depends less on the level of pay and more on its structure.

WAY TO POLICY

Putting the lessons taken from the evidences discussed above, following three immediate policy measures are desired at the moment for right kind of 'human resource preparedness'[46].

1. Make learning outcomes an explicit goal of primary education policy and invest in regular and independent high-quality measurement of learning outcomes. While independently measuring and administratively focusing on learning outcomes will not by itself lead to improvement, it will serve to focus the energies of the education system on the outcome that actually matters to millions of first-generation learners, which is functional literacy and numeracy.
2. Launch a national campaign of supplemental instruction targeted to the current level of learning of children (as opposed to teaching to the 'textbook') delivered by locally hired teacher assistants, with a goal of reaching minimum absolute standards of learning for all children. There is urgent need for a *mission-like* focus on delivering "universal functional literacy and numeracy" that allow children to *'read to learn'*. The evidence strongly supports scaling up supplemental instruction programmes using locally hired short-term teaching assistants that are targeted to the level of learning of the child, and the cost-effectiveness of this intervention also makes it easily scalable.
3. Pay urgent attention to issues of teacher governance including better monitoring and supervision as well as teacher performance measurement and management. A basic principle of effective management of organisations is to have clear goals and to reward employees for contributing towards meeting those goals. The extent to which the status quo does not do this effectively is highlighted in the large positive impacts found from even very modest improvements in the alignment of employee rewards with organisational goals. There can be potentially large returns of implementing these ideas in education and beyond.

The next decade will see the largest ever number of citizens in the school system at any point in Indian history (or future), and it is critical that this generation that represents the *demographic dividend* be equipped with the literacy and skills needed to participate fully in a rapidly modernising world. In a fiscally constrained environment, it is also imperative to use evidence to implement cost-effective policies that maximise the social returns on any given level of public investment. The growing body of high-quality research on primary education in the past decade provides opportunity for putting this principle into practice.

CAUTIONS TO PREPAREDNESS

The economic history of recent times is replete with examples of economies that were supposed to have great potential but ultimately did not achieve rapid economic growth and improvements in standards of living. We also have, at the same time, instances of economies classified as *basket cases* that achieved rapid turnarounds. India's achievement in the post-reform period and South Korea's rapid transformation surely fall in this latter category. But India's continuing on a rapid growth path is not preordained. Besides favourable circumstances, it requires deft policy making and a broad vision

of the future, possible risks, and opportunities. We stand at a crossroads where we need to develop a clear strategy for continued inclusive growth. Let us consider what might happen under different hypothetical scenarios based on informed estimates, which reflect the forces that will be at play: [47]

I. Business as Usual

Big aspirations of the 'demographic dividend' are not bad provided India goes for the timely and right kind of preparations for it. But if the 'business as usual' style of functioning continues, fallouts may be highly ugly.

- Some improvement in infrastructure but only slow improvement in education, and no change in institutional structure such as business regulation and labour laws.
- Some movement from agriculture to low skill services such as construction and household work, as well as to informal manufacturing, but too few quality jobs.
- GDP growth settles into a comfortable 6-7 per cent, the new "normal".
- There is growing presence of unprotected workers in manufacturing and the possibility of rising labour frictions.
- There is immense pressure on education to make students job-worthy, but with organised manufacturing playing little role in training workers and imparting skills on the job, there is a continuing mismatch between employer needs and worker capabilities.
- Growth is slower than it could be and inequality higher than it ought to be.

II. Reforms

In the times of globalising world being in sync with the time and contemporary world will be necessary. There will be requirement of speedier concensus on the fronts of 'economic reforms'. If the required kind of 'reforms' are effected at the 'right' times, outcomes may be glorious and historic –

- Vast improvements in infrastructure, education, as well as in business regulation and labour laws.
- As fewer workers depend on agriculture, larger holdings and more investment in capital and technology create a much healthier agricultural sector, with significant rural entrepreneurship surrounding activities like horticulture, dairy products, and meat.
- The manufacturing sector becomes a training ground for workers, absorbing more students with a middle or high school education.
- India moves into niches vacated by China such as semi-skilled manufacturing, even while enhancing its advantage in skilled manufacturing and services.
- India experiences faster and more equitable growth.
- Social frictions are minimized as both agriculture and manufacturing create better livelihoods.

III. Decline

Suppose India fails or lags in the process of putting the 'required set of things' in place, so that it can

strengthen its position to garner higher demographic dividend – i.e. no improvement in infrastructure, education, or institutions . Just visualise the resulting ugly scenarios –

- As fewer jobs are created outside of agriculture, more people stay in agriculture, increasing the pressure on land and lowering incomes. Small agricultural plots do not provide enough income, nor can they be leased out.
- More families break up, with males seeking work elsewhere, and labour participation increases.
- There is large-scale migration to overburdened cities.
- More supports are given to agriculture and transfers are made to rural areas so as to prevent further migration.
- The strain on government finances increases.
- Income inequality between good service jobs in cities and marginal agricultural jobs in rural areas increases tremendously.
- Social strains/tensions grow.

The above-given scenarios are *clear posibealites* and should be seen as 'indicative' rather than conclusive in any way. The key policy message from this chapter is that India has to focus on an agenda to create productive jobs outside of agriculture, which will help it reap the *demographic dividend* and also improve livelihoods in agriculture.India needs to examine carefully whether regulations constrain businesses excessively and, if so, stripping the excess regulation while ensuring adequate protection and minimum safety nets for workers, will be the need of the time. Building infrastructure and expanding access to finance will also help. The government looks clearly engaged in this process, further steps need greater debate and action. Future governments will also be required to follow them. Continuity will be playing a very crucial role in this phase thus it will be advisable that not only the government in the seat of power but the opposition in the Parliament also accepts the delicacy of the moment and tries to build a concensus coming above the petty politics of the past. This becomes even more important when Indian politics is crossing through the phase of coalition governments in the Centre. Together with the Union Government the active support from the State Governments will be the need of the time and the process of planning may be used here tuned with the idea of 'monitorable targets', to attain this end.

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* LFP is a measure of the active portion of an economy's labor force. It refers to the number of people who are either employed or are actively looking for work. The number of people who are no longer actively searching for work would not be included in the participation rate. During recession many workers often get discouraged and stop looking for employment that is why the participation rate decreases.

** TFP measures how productive the job intrinsically is, capturing aspects such as the technology used, efficiency with which the work is carried out, and use of hard-to-measure aspects of work such as tacit knowledge, organisational capabilities, and trust.

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17. Various issues of the ***Economic Survey;*** Employment and Unemployment Situation in India (various years), NSSO, Ministry of Statistics and Programme Implementation (MOSPI); ***Census of India***, as has been presented by the ***Economic Survey 2012-13,*** MoF, GoI, p. 42. *Notes* : Industry includes manufacturing, construction, mining, and utilities. Organized-sector employment is obtained from the ***Economic Survey***. The organized sector consists of non-agricultural establishments in the private sector that have 10 workers or more, and all establishments irrespective of size in the public sector. For the other subsectors within industry, the organized sector essentially refers to all companies and government administrations. Unorganized-sector employment is estimated by deducting estimates of organized employment from total employed workforce. Total employment is generated by multiplying the worker population ratio (from the NSSO Employment-Unemployment Surveys) by the estimated population of India as per ***Census*** sources.
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22

HUMAN DEVELOPMENT IN INDIA

The basic purpose of development is to enlarge 'people's choices'. In principle, these choices can be infinite and can change over time. People often value achievements that do not show up at all, or not immediately, in income or growth figures: greater access to knowledge, better nutrition and health services, more secure livelihoods, security against crime and physical violence, satisfying leisure hours, political and cultural freedoms and sense of participation in community activities. The objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives.

- Introduction
- Human & Gender Development
- Inclusive Development
- Poverty
- Inequality
- Employment
- Socio-Economic and Caste Census
- Poverty Alleviation and Employment Generation Programmes
- Social Protection
- Rural Infrastructure
- Urban Infrastructure
- Skill Development
- Education
- Aser 2012
- Health
- Women and Child Development

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* Mahbub ul Haq (1934–1998), Founder of the Human Development Report, UNDP, 1990.

INTRODUCTION

Income enhancement does not automatically bring in development, rather it needs support of a conscious public policy with committment of good governance. After the worlds acceptance of welfare economics the standard of life of the masses has emerged as a popular measuring scale of development for the economies–to a great extent, synonymous to the UNDP concept of human development.[1]

The Government of India has been conscious ever since Independence about the development of the social sector which includes areas like, health, education, shelter, social welfare, social security etc. Once the economy went for the process of economic reforms, a higher emphasis was felt on these areas by the government and experts alike. Increasing emphasis on the social sector is clearly visible from 1991 onwards.[2]

The ultimate objective of development planning is human development or increased social welfare and well-being of the people. Increased social welfare of the people requires a more equitable distribution of development benefits along with better living environment. Development process therefore needs to continuously strive for broad-based improvement in the standard of living and quality of life of the people through an inclusive development strategy that focuses on both income and non-income dimensions. The challenge is to formulate *inclusive* plans to bridge regional, social and economic disparities. The Eleventh Five Year Plan sought to address this challenge by providing a comprehensive strategy for inclusive development, building on the growing strength of the economy. This strategy has to be continued and consolidated further in the Twelfth Five Year Plan. The Approach Paper to the Twelfth Five Year Plan (2012–17) rightly stresses the need for more infrastructural investment with the aim of fostering a faster, sustainable and more inclusive growth.

This chapter focuses on issues related to **'inclusive development'** in India and uses both international as well as inter–state comparisons to shed light on the subject. Apart from highlighting the international position of India vis-à-vis other emerging market economies and similarly placed countries in terms of the human development index (HDI), an attempt has been made to examine the interrelations between different parameters of the HDI.

From the domestic angle, the chapter focuses on trends in social-sector spending both at the centre and the state levels. It looks at social-sector policies implemented by the government, particularly poverty alleviation and employment generation, health, education, rural infrastructure, development of the weaker sections of society, women and child development, and social security. It also discusses climate change and its impact on development in the context of intergenerational equity.

HUMAN & GENDER DEVELOPMENT

The widely quoted document to know about India's 'Human' and 'Gender' related situations is the HDR released by the United Nations Development Programme (UNDP). The ***Human Development Report-2013*** of the UNDP, released on *March 14, 2013*, puts India's HDI value for the last year at 0.554, placing it in the *medium human development category* (which it shares with *Equatorial*

Guinea). India has been ranked **136** among 187 countries evaluated for human development index (HDI) – a measure for assessing progress in 'life expectancy', 'access to knowledge' and a decent 'standard of living' or 'gross national income per capita (at PPP)'. Some of the highlights of the HDR-2013 about India may be seen as given below:

- On the positive side, India's HDI value went up from 0.345 to 0.554 *between 1980 and 2012*, an increase of *61 per cent* or an average annual increase of 1.5 per cent.
- Despite India's progress, its HDI of 0.554 is below the average of 0.64 for countries in the medium human development group, and of 0.558 for countries in South Asia.
- From South Asia, countries which are close to India's HDI rank and population size are Bangladesh and Pakistan with HDIs ranked 146 each. But the report points out that the ranking masks inequality in the distribution of human development across the population.
- Life expectancy at birth increased by 10.5 years, mean years of schooling by 2.5 years and expected years of schooling by 4.4 years (1980-2012).
- Importantly, the gross national income (GNI) per capita went up by 273 per cent, the report says (1980-2012).
- On the *Gender Inequality Index* – inequalities in reproductive health, empowerment and economic activity – India has been ranked 132 among the 148 countries (for which data is available).
- In India, only **10.9** per cent of the Parliamentary seats are held by women, and **26.6** per cent of adult women have reached a secondary or higher level of education, compared with **50.4** per cent of their male counterparts.
- For every 100,000 live births, 200 women die of causes related to pregnancy (i.e., *Maternal Maortality Rate*), and female 'participation in the labour market' is 29 per cent, compared with 80.7 per cent for men.
- As for the *Multidimensional Poverty Index (MPI),* which identifies multiple deprivations in the same household in education, health and living standard, India's value averages out at **0.283** (a little above Bangladesh's and Pakistan's).
- The figures for evaluating MPI have been drawn from the 2005-06 survey, according to which 53.7 per cent of the population lived in multidimensional poverty, while an additional 16.4 per cent were vulnerable to multiple deprivations.

The Report notes that **social movements** and the specific issues media highlight do not always result in political transformations benefiting the broader society. Citing the example of ***Anna Hazare's*** 'movement' against corruption, which pressured the government for change, the report says critics, however, point out that such a campaign can favour policies that may not be supported by a wider electorate. 'Thus, it is important to institutionalise a participatory process that can adjust the political balance by providing a platform for excluded citizens to demand accountability and redress of inequities, ranging from systemic discrimination to unfair and unjust exclusion,' the report adds.

There is a *word of appreciation* for India for its policies on **internal conflicts**. 'India has shown that while policing may be more effective in curbing violence in the short term, redistribution and overall development are better strategies to prevent and contain civil unrest in the medium term,' the report says, referring to *Operation Green Hunt* launched against Maoists, which has come under sharp

criticism from human rights activists within the country. The other initiatives that have been lauded are the **right to education** and the **rural employment guarantee scheme** (MGNREGA) that provides up to 100 days of unskilled manual labour to eligible poor at a statutory minimum wage. 'This initiative (the job guarantee scheme) is promising because it provides access to income and some insurance for the poor against the vagaries of seasonal work and affords individual the self-respect and empowerment associated with work,' the report says.

INCLUSIVE DEVELOPMENT

This section and the one that follows on social sector initiatives, examine the major dimensions of inclusive development like poverty alleviation, employment generation, health, education, and social welfare besides giving the progress of important government programmes in those sectors.

Inclusive development can be viewed in terms of progress in social and financial inclusion. A large part of the population, particularly segments like landless agricultural labourers, marginal farmers, scheduled castes (SCs), scheduled tribes (STs), and other backward classes (OBCs), continue to suffer social and financial exclusion. Accordingly, the government's policies are directed towards economic and social upliftment of these segments so as to enable everyone to reap the benefits of growth and bring marginalised sections of the society into the mainstream. This is also reflected in social-sector expenditure by the government.

Expenditure on Social Sector

Central support for social programmes has continued to expand in various forms although most social-sector subjects fall within the purview of the states. In the post-reform period, governments concern for the social sector has increased in a big–way. As per the latest *Economic Survey 2012–13,* India's expenditure trends on social sector today are given below –

(i) **Central government** expenditure on 'social services and rural development' (Plan and non-Plan) has increased from **14.77** per cent in 2007–08 to **17.39** per cent in 2012–13 (BE) with an *all-time high* of **18** per cent in 2010–11 due to the combined effect of higher expenditure under the Pradhan Mantri Gram Sadak Yojana (PMGSY) and education.

(ii) **General Government** (centre and states combined – Plan and Non-plan) expenditure on social services has also shown increase in recent years reflecting the higher priority given to this sector –

   (a) Expenditure on social services ***as a proportion of total expenditure*** increased from 22.4 per cent in 2007–08 to 24.7 per cent to 25 .1 per cent in 2012–13 (BE). Among social services, the share of expenditure on *education* has increased from 43.9 per cent in 2007–08 to **46.6** per cent in 2012–13 (BE), while that on *health* has 'fallen' from 21.5 per cent to **19.2** per cent.

   (b) As a ***proportion of the gross domestic product*** (GDP), expenditure on social services increased from 5.91 per cent in 2007–08 to 6.79 per cent to 7.09 per cent in 2012–13 (BE). While expenditure on *education* as a proportion of GDP has increased from 2.59 per cent in 2007–08 to **3.31** per cent in 2012–13 (BE), that on *health* has increased from

1.27 per cent in 2007–08 to **1.36** per cent in 2012–13 (BE).

Health is the most important determining factor of 'living standard' of a society – continues to be an area of concern – for India. India's expenditure on health as a per cent of GDP is very low compared to many other emerging and developed countries. Unlike most countries, in India, private-sector expenditure on health as a percentage of GDP is higher than public expenditure and was more than double in 2010. Despite this, the total expenditure on health as a percentage of GDP is much lower than in many other developed and emerging countries and the lowest among *BRICS* (Brazil, Russia, India, China and South Africa) countries.

POVERTY

Since India commenced the process of economic reforms, a major shift has taken place in the country's policy-orientation towards poverty alleviation and employment generation – in place of *wage employment*, the focus has shifted to *self-employment* – so that 'gainful employment' could be created and poverty could be alleviated permanently.[3]

The Planning Commission estimates poverty using data from the large sample surveys on household consumer expenditure carried out by the National Sample Survey Office (NSSO) *every five years*. It ***defines*** poverty line on the basis of monthly per capita consumption expenditure (MPCE).

The methodology for estimation of poverty followed by the Planning Commission has been based on the recommendations made by experts in the field from time to time. The Expert Group headed by ***Prof. Suresh D. Tendulkar*** which submitted its report in December 2009 has computed the poverty lines at all India level as MPCE of Rs. 447 for rural areas and Rs. 579 for urban areas in 2004-05. After 2004-05, this survey has been conducted in 2009-10.

The Planning Commission has updated the poverty lines and poverty ratios for the year 2009-10 as per the recommendations of the Tendulkar Committee using NSS 66th Round (2009-10) data from the 'Household Consumer Expenditure Survey'. It has estimated the poverty lines at all India level as an MPCE of Rs. 673 for rural areas and Rs. 860 for urban areas in 2009-10. Based on these cut-offs, the percentage of people living below the poverty line in the country has declined from **37.2** per cent in 2004-05 to **29.8** per cent in 2009-10. Even in absolute terms, the number of poor people has fallen by 52.4 million during this period. Of this, 48.1 million are rural poor and 4.3 million are urban poor. Thus, poverty has *declined on an average by 1.5 percentage* points per year between 2004-05 and 2009-10. The annual average rate of decline during the period 2004-05 to 2009-10 is twice the rate of decline during the period 1993-94 to 2004-05.

Infant mortality rate (IMR) which was 58 per thousand in the year 2005 has fallen to 44 in the year 2011. The number of rural households provided toilet facilities annually have increased from 6.21 lakh in 2002-3 to 88 lakh in 2011-12. Similarly MPCE (at constant prices) has also increased from Rs. 558.78 and Rs. 1052.36 during 2004-5 to Rs. 707.24 and Rs. 1359.75 in 2011-12 in rural and urban areas respectively. The improvement in these social indicators is also a reflection of fall in deprivation. The Planning Commission has also constituted an Expert Group under the Chairmanship of Dr. C. Rangarajan to 'Review the Methodology for Measurement of Poverty' in June 2012.

INEQUALITY

HDR measures inequality in terms of two indicators. The first indicator is the income **Gini Coefficient** which measures 'the deviation of distribution of income (or consumption) among the individuals within a country' from a perfectly equal distribution. For India, the income Gini coefficient was **36.8** in 2010-11. In this respect, inequality in India is lower than many other developing countries, e.g., South Africa (57.8), Brazil (53.9), Thailand (53.6), Turkey (40.8), China (41.5), Sri Lanka (40.3), Malaysia (46.2), Vietnam (37.6), as well as countries like USA (40.8), Hong Kong (43.4), Argentina (45.8), Israel (39.2), Bulgaria (45.3) etc., which are otherwise ranked very high in terms of human development index.

The second indicator is the **quintile income ratio**, which is a 'measure of average income of the richest 20 per cent of the population to that of poorest 20 per cent'. The quintile income ratio for India was **5.6** in 2010-11. Countries like Australia (7.0), the USA (8.5), New Zealand (6.8), Singapore (9.8), the UK (7.8), Argentina (12.3), Mexico (14.4), Malaysia (11.4), Philippines (9.0), Vietnam (6.2) had higher ratios. This implies that the inequality between the top and bottom quintiles in India was lower than a large number of countries.

To estimate the ***rural-urban gap***, the monthly per capita expenditure (MPCE) defined first at household level to assign a value that indicates the level of living to each individual or household is used. According to the provisional findings of the 68th round (2011-12) of the NSS, average MPCE (Uniform Reference Period based) is Rs. 1281.45 and Rs. 2401.68 respectively for rural and urban India indicating rural-urban income disparities.

However, monthly per capita rural consumption rose by **18** per cent in real terms in 2011-12 over 2009-10, while monthly per capita urban consumption rose by only **13.3** per cent. Thus, the rate of increase in the MPCE of rural areas is higher than that of urban areas, indicating a bridging of the rural-urban gap. Out of the MPCE, the share of food as per 66th round NSS data (2009-10) is Rs. 600 (57 per cent) and Rs. 881 (44 per cent) for rural and urban India, respectively, showing a higher share for food in rural compared to urban India [as per the latest *Economic Survey 2012-13*].

EMPLOYMENT

For growth to be inclusive, it must create adequate livelihood opportunities and add to decent employment commensurate with the expectations of a growing labour force. The Eleventh Five Year Plan (2007-12) aimed at generation of 58 million work opportunities. The NSSO quinquennial survey has reported an increase in work opportunities to the tune of 18 million under the current daily status (CDS) between 2004-05 and 2009-10. However, the overall labour force expanded by only 11.7 million. This was considerably lower than in comparable periods earlier, and can be attributed to the much larger retention of youth in education and also because of lower labour force participation among working-age women. As a result, unemployment in absolute terms came down by 6.3 million. The lower growth in the labour force is not expected to continue as educated youth are expected to join the labour force in increasing numbers during the Twelfth Plan and in the years beyond.

This means that the pace of job/ livelihood creation must be greatly accelerated. The Twelfth Plan Approach Paper therefore lays greater stress on skill building which can be viewed as an instrument for improving the effectiveness and contribution of labour to overall production. This will push the production possibility frontier outward and take the economy on to a higher growth trajectory and can also be viewed as a means of empowerment.

Unemployment

Unemployment was higher under both the UPSS and CWS but rural unemployment was higher under the CDS approach. This possibly indicates higher intermittent or seasonal unemployment in rural than urban areas, something that employment generation schemes like the MGNREGA need to pay attention to. However, overall unemployment rates were lower in 2009-10 under each approach vis-a-vis 2004-5. Labour force participation rates (LFPR) under all three approaches declined in 2009-10 as compared to 2004-5. However, the decline in female LFPRs was larger under each measure in comparison with male LFP which either declined marginally (UPSS), remained constant (CWS), or increased marginally (CDS).

Employment growth in the ***organized sector***, public and private combined, has increased by 1.9 per cent in 2010, which is lower than the annual growth for the previous year. The annual growth rate for the private sector was much higher than that for the public sector. However, in respect of both sectors, *annual increase in employment had slowed down* in 2010 vis-à-vis 2009. The share of women in organised-sector employment was 20.4 per cent in 2010 March end and has remained nearly constant in recent years. Only 15.6 per cent of the total workforce had regular wage employment/salaried work during 2009-10 while 33.5 per cent was casual labour and 51 per cent was self-employed (*'Employment Situation in 2010-11'* as *per Quarterly Survey Reports*). The ***Labour Bureau*** conducted twelve quarterly quick employment surveys to assess the impact of the economic slowdown on employment in India. These surveys indicate that the upward trend in employment since July 2009 has been maintained.

Comparative Human Development of States

One of the objectives of inclusive development is 'narrowing inter-state and inter-regional disparities'. As per the latest *Economic Survey 2012-13* the 'Inter-state comparisons of socio-economic development' of selected major states based on available indicators from different sources show some interesting results –

Population Related

Bihar has the *highest* decadal (2001-11) growth rate of population (25.07 per cent), while Kerala has the lowest rate (4.86 per cent). Some big states like Gujarat, Haryana, Madhya Pradesh, Rajasthan, and Uttar Pradesh also have high decadal growth of population.

In 2011, Kerala has the *highest sex ratio* with 1084 females per 1000 males, followed by Tamil Nadu (995), while Haryana is at the bottom (877). Interestingly, the sex-ratios in some of the developed states like Gujarat and Maharashtra are also low at 918 and 925, respectively.

Growth Related

The *best performers* in terms of growth during 2011-12 are *Bihar* (**16.71** per cent) followed by

Madhya Pradesh and Maharashtra. The growth of these states is much above the all India average. The *worst performers* are Rajasthan (5.41 per cent) followed by Punjab and Uttar Pradesh. States with the highest growth rate for the period 2005-06 to 2011-12 are *Bihar* (**10.17** per cent) followed by Gujarat and Maharashtra. In terms of growth in *per capita income*, the best performer is *Bihar* (**15.44** per cent) followed by Madhya Pradesh and Maharashtra due to high growth in gross state domestic product (GSDP) in 2011-12 and despite their high decadal growth in population. Per capita income growth is the lowest in Rajasthan (3.72 per cent), followed by Uttar Pradesh, Punjab, and Odisha which are all below the all India per capita income growth.

Poverty

The poverty estimates indicate that the *highest* poverty headcount ratio (HCR) exists in *Bihar* at 53.5 per cent as against the national average of 29.8 per cent. In 2009-10 compared to 2004-5, Bihar has displaced Odisha as the poorest state, Socio-Economic and Caste Census (SECC) with Odisha's situation improving considerably in 2009-10. Lowest poverty is in Himachal Pradesh (9.5 per cent) followed by Kerala (12 per cent).

Rural-Urban Disparity

Bihar has the lowest MPCE both in rural and urban areas at Rs. 780 (with 65 per cent food share) and Rs.1238 (with 53 per cent food share) respectively. In comparison, Kerala has the highest in both rural and urban areas at Rs.1835 (with 46 per cent food share) and Rs. 2413 (with 40 per cent food share), respectively. It is obvious that poorer states spend a greater proportion of income on food in total consumption expenditure.

Unemployment

As per usual status(adjusted) NSS 66th round 2009-10, the unemployment rate (per 1000) among the major states is the *lowest* in Gujarat (18) and *highest* in Kerala (73) and Bihar (73) in urban areas and the lowest in Rajasthan (4) and again highest in Kerala (75) in rural areas.

The low unemployment rate in rural areas in Rajasthan may partly be due to high absorption of MGNREGA funds in the state. Kerala, which has performed well in terms of most indicators, performs less in terms of unemployment (both rural and urban). This may be due to the higher level of education in Kerala resulting in people not opting for manual jobs as observed by some studies.

Health

Kerala is the *best* performer in terms of *life expectancy* at birth for both males (71.5 years) and females (76.9 years) whereas Assam is the worst performer for both males (61 years) and females (63.2 years) during 2006-10. *Infant mortality rate* (IMR) in 2011 is the lowest in Kerala (12) and highest in Madhya Pradesh (59) against the national average of 44. *Birth rate* is lowest in Kerala (15.2) and highest in Uttar Pradesh (27.8) against the national average of 21.8. Death rate is lowest in West Bengal (6.2) and highest in Odisha (8.5) against the national average of 7.1.

Education

Madhya Pradesh has the *highest* gross enrolment ratio (GER) (6-13 years) in 2010-11 while Assam has the lowest. *Pupil-teacher ratios* in primary and middle/basic schools are the lowest in Himachal Pradesh and high in states like Uttar Pradesh and Bihar.

Financial Inclusion

In terms of decadal growth rate in bank branches, Haryana (59.5 per cent) has the *highest* growth and

Bihar the lowest (14.4 per cent). Among worth eastern states Assam is placed at 16.5 per cent. Himachal Pradesh (89.1 per cent) has the highest percentage households availing of banking services while Assam (44.1 per cent) is the lowest followed by Bihar (44.4 per cent). Thus, in terms of both these financial inclusion indicators, Bihar's performance is *among the worst*.

Key Social Sector Programmes

While there are state-wise indicators for some social-sector programmes, it is not possible to evaluate the performance of states based just on numbers. The average persondays per household under the MGNREGA in 2011-12 is *the highest* in Andhra Pradesh (58 days) followed by Himachal Pradesh (53 days) and *lowest* in Assam and Punjab (both 26 days) against the ***national average*** of 43 days.

While the share of women's employment under the MGNREGA is the highest in Kerala (92.76 per cent) followed by Tamil Nadu (73.36 per cent), it is the lowest in Uttar Pradesh (16.98 per cent). While the stipulation of one-third women's participation has been maintained at the all India level, in states like Uttar Pradesh, Assam, and Bihar, it has been below the stipulated level.

Progress in terms of 24x7 primary health centres (PHCs), additional PHCs, CHCs and other subdistricts health facilities under the NRHM is the highest in Tamil Nadu and lowest in Himachal Pradesh. Under the Indira Awas Yojana (IAY), Bihar has the highest share followed by Uttar Pradesh and Andhra Pradesh, whereas Himachal Pradesh has the lowest.

Conclusive Remarks

(i) Thus, the inter-state comparison of performance of states based on different indicators shows that while some states have performed well in terms of growth indicators, they have performed poorly in terms of other indicators like poverty, rural-urban disparity, unemployment, education, health and financial inclusion. This calls for a rethink on the criteria used for devolution of funds to states under Finance Commissions where criteria like ***'income distance'*** (12th Finance Commission) or ***'fiscal capacity distance'*** (13th Finance Commission) along with population are given high weightage and none of the human development indicators or financial inclusion indicators are used.

(ii) Similarly, the criteria used for awarding 'special category status to states' (hilly and difficult terrain, low population density and/or sizable share of tribal population, strategic location along borders with neighbouring countries, economic and infrastructural backwardness, and non-viable nature of state finances) need to be revisited.

SOCIO-ECONOMIC AND CASTE CENSUS

The identification of the real beneficiaries is of paramount importance, for the success of any targeted approach. In line with this approach the *Dr. N. C. Saxena Committee* was constituted to advise on the 'methodology for a BPL census in rural areas'. Since June 2011, for the first time, a ***Soci-Economic and Caste Census (SECC)*** is being conducted – through a comprehensive door-to-door enumeration

in both rural and urban India, authentic information is being made available on the socio-economic condition and educational status of various castes and sections through the SECC.

This exercise will help better target government schemes to the right beneficiaries and ensure that all eligible beneficiaries are covered, while all ineligible beneficiaries are excluded. Households identified as highly deprived will have the highest inclusion priority under government welfare schemes. Use of the *Aadhar* number in various beneficiary-oriented social–sector programmes will also check duplications.

The *SECC 2011* is being conducted simultaneously for rural and urban areas by the respective states, with technical and financial support from the GoI. Enumeration is to be done with the help of about 6 lakh enumerators, who are accompanied by an equal number of technically qualified and computer literate Data Entry Operators (DEO) selected by the country's premier IT majors. The Ministry of Rural Development in association with the Ministry of Housing and Urban Poverty Alleviation, Office of the Registrar General of India (RGI) and the states have shouldered the responsibility of training the enumerators, supervisors, verifiers, and state officials engaged in the census operation. The SECC process ensured transparency and people's participation.

Before finalising the outcomes, the household data, except caste data, will be placed in the public domain for scrutiny and go through a two-stage appeal procedure in the 'claims and objections' stage. In rural areas, the Gram Sabha will also mandatorily scrutinise the data in a specially convened meeting.

As per the latest *Economic Survey 2012-13* (which quotes the Ministry for Rural Development), enumeration under SECC 2011 has been completed in 2,339,926 enumeration blocks (EBs) comprising **94.26** per cent of the total EBs of all the states as on *31 December 2012*.

The government has constituted an ***Expert Committee*** under the chairpersonship of *Prof. Abhijit Sen*, Member Planning Commission, to examine the SECC indicators and the data analysis and recommend appropriate methodologies for determining classes of beneficiaries for different rural development programmes. It will consult states, experts, and civil society organisations while arriving at these methodologies.

POVERTY ALLEVIATION AND EMPLOYMENT GENERATION PROGRAMMES

To achieve inclusive development, several poverty-alleviation and employment-generation programmes are being implemented by the Government of India. Some of the important schemes are as follows:

I. MGNREGA

This flagship programme of the Government of India aims at enhancing livelihood security of households in rural areas of the country by providing at least one hundred days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled

manual work. It also mandates 1/3 participation for women. The primary ***objective*** of the scheme is to augment wage employment. This is to be done while also focusing on strengthening natural resource management through works that address causes of chronic poverty like drought, deforestation and soil erosion, and thus encourage sustainable development.

Notified in 2006 in 200 districts, the flagship programme today is implemented in ***all districts*** with rural areas. For 2012-13 the total outlay was Rs. 33,000 crore – 4.39 crore households have been provided employment of 156.01 crore persondays of which 82.58 crore *(53 per cent)* were availed by women, 34.56 crore *(22 per cent)* by SCs, and 24.90 crore *(16 per cent)* by STs.

At the national level, with the average wage paid under the MGNREGA increasing from Rs. 65 in 2006-7 to Rs. 115 in 2011-12, the ***bargaining power*** of agricultural labour has increased as even private sector wages have increased as shown in many studies (said by the *MGNREGA Sameeksha 2012*). Improved economic outcomes, especially in watershed activities, and reduction in distress migration are its other achievements. Wages under the MGNREGA are indexed to the consumer price index for agricultural labour *(CPI-AL)*.

As per the latest *Economic Survey 2012-13* (which quotes the Ministry for Rural Development), the GoI has taken the following new initiatives to make MGNREGA effective and focused –

(i) The basket of permissible activities has been expanded to make it more meaningful.

(ii) Electronic Fund Management System (eFMS) in all states has been initiated in a phased manner to reduce delay in payment of wages.

(iii) Additional employment over and above 100 days per household in notified drought-affected talukas/blocks is now permissible.

(iv) Provision has been made for seeding in Aadhaar into the MGNREGA workers records to prevent leakage.

(v) Convergence of the MGNREGA with the Total Sanitation Campaign (TSC) has been undertaken.

The *Survey* further adds, ‘with better planning of project design, capacity building of panchayati raj institutions (PRIs), skill upgradation for enhanced employability, and reduction of transaction costs, gaps in implementation could be plugged to a greater extent and the assets so created could make a much larger contribution to increasing land productivity’.

II. Swarnjayanti Gram Swarozgar Yojana

The Swarnjayanti Gram Swarozgar Yojana (SGSY) is a *self-employment* programme with the objective of helping poor rural families cross the poverty line by assisting them to take up income-generating economic activities through a mix of bank credit and government subsidy. The SGSY specially focuses on vulnerable sections among the rural poor with SCs/STs to account for at least 50 per cent and women 40 per cent of the *swarozgaris*. Under the special project component of the SGSY, a placement-linked skill development programme has been taken up – in each district of the country, one Rural Self Employment Training Institute (RSETI) has to be set up for basic and skill development training of rural below poverty line (BPL) youth to enable them to undertake micro-enterprise and wage employment. The SGSY has now been restructured as the *National Rural Livelihoods Mission* (NRLM). The NRLM ***aims*** at reducing poverty by enabling poor households to

access gainful self-employment and skilled wage employment opportunities. This should result in appreciable improvement in their livelihoods on a sustainable basis through building strong and sustainable grassroots institutions. The salient features of the NRLM are:

(i) At least one member from each identified rural poor household, preferably a woman, to be brought under the SHG network in a time-bound manner, the ultimate target being 100 per cent coverage of BPL families;

(ii) Setting up of strong institutions of the poor such as SHGs for reducing dependence on external agencies;

(iii) A multi pronged approach envisaged for continuous capacity building of the targeted families, SHGs, their federations, government functionaries, bankers, NGOs, and other key stakeholders;

(iv) Subsidy to be available in the form of revolving fund and capital subsidy as an incentive for inculcating the habit of thrift and accumulation of their own funds towards meeting their credit needs in the long run and immediate consumption needs in the short run;

(v) To work towards universal financial inclusion beyond and partial/permanent disability of the head of the family of rural landless households in the country. Under the scheme, the head of the family or an earning member is eligible for receiving the benefit of Rs. 30,000 in case of natural death, Rs. 75,000 for accidental death, Rs. 75,000 for total permanent disability and Rs. 37,500 for partial permanent disability.

III. Swarna Jayanti Shahari Rozgar Yojana

The Swarna Jayanti Shahari Rozgar Yojana (SJSRY) was launched by the Government of India on December 1, 1997 to provide gainful employment to the urban unemployed and underemployed by encouraging the setting up of self-employment ventures or provision of wage employment. This scheme subsumed the earlier three urban poverty-alleviation programmes and was also revamped with effect from April 2009 to include the Urban Self Employment Programme (USEP), Urban Women Self-help Programme (UWSP), Skill Training for Employment Promotion amongst Urban Poor (STEP-UP), Urban Wage Employment Programme (UWEP), and Urban Community Development Network (UCDN).

SOCIAL PROTECTION

To provide a minimum level of social protection to workers in the *unorganized sector* and ensure inclusive development the coverage of social security schemes has been expanded which include:

Aam Admi Bima Yojana (AABY)

The Janashree Bima Yojana (JBY) has now been merged with the AABY to provide better administration of life insurance cover to the economically backward sections of society. The scheme extends life and disability cover to persons between the ages of 18 and 59 years living below and marginally above the poverty line under 47 identified vocational/occupational groups, including

‘rural landless households’. It provides insurance cover of a sum of Rs. 30,000 on natural death, Rs. 75,000 on death due to accident, Rs.37,500 for partial permanent disability due to accident, and Rs. 75,000 on death or total permanent disability due to accident. The scheme also provides an add-on benefit of scholarship of Rs. 100 per month per child paid on half-yearly basis to a maximum of two children per member studying in Classes 9 to 12 (including ITI courses). The total annual premium under the scheme is Rs. 200 per beneficiary, of which 50 per cent is contributed from the Social Security Fund created by the central government and maintained by the Life Insurance Corporation of India (LIC). The balance 50 per cent is contributed by beneficiary/state governments/union territory (UT) administrations. The scheme is being implemented through the LIC.

Rashtriya Swasthya Bima Yojana (RSBY)

The scheme provides smart card-based cashless health insurance cover of Rs. 30,000 per family per annum on a family floater basis to BPL families in the unorganized sector with the premium shared on ***75:25*** basis by central and state governments. In case of states of the north-eastern region and Jammu and Kashmir, the premium is shared in the ratio of ***90:10***. The scheme provides for portability of smart card by splitting the card value for migrant workers – being implemented in 27 states/ UTs with *smart cards*.

UWSCA & NSSF

The UWSCA (Unorganised Workers Social Security Act, 2008) provides for constitution of a National Social Security Board and State Social Security Boards which will recommend social security schemes for unorganised workers. The National Social Security Board was constituted in August 2009. It has made some recommendations regarding extension of social security schemes to certain additional segments of unorganized workers. A National Social Security Fund (NSSF) with initial allocation of Rs. 1,000 crore to support schemes for weavers, toddy tappers, rickshaw pullers, beedi workers, etc. has also been set up.

Social Security Agreements (SSAs)

The SSA, a bilateral instrument to protect the interests of Indian professionals as well as self-employed Indians working in foreign countries, was initiated by signing an SSA between India and Belgium on November 3, 2006. So far India has signed ***15 SSAs*** with Belgium, Germany, Switzerland, France, Luxembourg, Netherlands, Hungary, Denmark, Czech Republic, Republic of Korea, Norway, Finland, Canada, Sweden, and Japan. These SSAs facilitate mobility of professionals between two countries by exempting them from double payment of social security contributions and enables them to enjoy the benefits of exportability and totalisation.

RURAL INFRASTRUCTURE

The Government of India has been according high priority over the years to building rural infrastructure with the objective of facilitating a higher degree of rural-urban integration and for

achieving an even pattern of growth and opportunities for the poor and disadvantaged sections of society. Programmes for achieving this include the following:

Bharat Nirman

This programme, launched in 2005-06 for building infrastructure and basic amenities in rural areas, has six components, namely rural housing, irrigation potential, drinking water, rural roads, electrification, and rural telephony. A goal has been set to provide connectivity to all villages with a population of 1,000 (500 in hilly or tribal areas) with all-weather roads.

Indira Aawas Yojana (IAY)

The IAY is one of the six components of the Bharat Nirman programme. The unit assistance provided to rural BPL households for construction of a dwelling unit under the IAY has been revised with effect from April 1, 2010 from Rs. 35,000 to Rs. 45,000 for plain areas and from Rs. 38,500 to Rs. 48,500 for hilly/ difficult areas. In addition, construction of IAY houses have been included in the differential rate of interest (DRI) scheme for lending up to Rs. 20,000 per housing unit at an interest rate of 4 per cent. Sixty left wing extremism (LWE) affected districts have been made eligible for a higher rate of unit assistance of Rs. 48,500. Under this scheme a homestead site of 100-250 sq.m will be provided to those rural BPL households who have neither land nor a house site. For this purpose, Rs. 10,000 per beneficiary, to be shared by the centre and states in a 50:50 ratio, will be provided to the District Rural Development Agencies (DRDAs).

Rural drinking water

Drinking water supply is one of the components of Bharat Nirman. The present status of provision of safe drinking water in rural areas as measured by habitations where the population is fully covered, as per information reported by the states is that about 72 per cent of rural habitations are fully covered. The rest are either partially covered or have chemically contaminated drinking water sources. The States of Jharkhand, Chhattisgarh, Nagaland, Madhya Pradesh, Odisha, Himachal Pradesh, Tamil Nadu, Kerala, and Uttarakhand have exceeded their targets whereas Sikkim, Punjab, Assam, Rajasthan, Arunachal Pradesh, and Jammu and Kashmir have reported low (less than 50 per cent) achievement against targets. As per the policy initiatives of the Eleventh Five Year Plan document, the guidelines for the Rural Water Supply Programme were revised in 2009 and renamed the *National Rural Drinking Water Programme* (NRDWP). The ***Jalmani*** programme, a scheme to provide 100 per cent assistance to states for installing stand-alone water purification systems in schools in rural areas was launched in 2008-09.

Rural Sanitation-Total Sanitation Campaign (TSC)

The TSC is one of the flagship programmes of the government. The TSC follows a community-led and people-centric approach, laying emphasis on information, education, and communication (IEC) for demand generation for sanitation facilities. To motivate the community towards creating sustainable sanitation facilities and their usage, the incentive for Individual household latrines for BPLhouseholds has been increased from Rs. 2,200 (Rs. 2,700 for hilly and difficult areas) to Rs. 3,200 (Rs. 3,700 for hilly and difficult areas) with effect from June 1, 2011. With the scaling up of the TSC, combined with higher resource allocation, programme implementation has improved substantially. The TSC has now turned into an inclusive programme, with participation of all sections of society. Provision of earmarked funds has been made for SCs and STs for inclusive growth of all sections of society. The active participation of women and adolescent girls in the sanitation programme has been encouraged

with special components for them. The Nirmal Gram Puraskar (NGP) incentive scheme has been launched to encourage PRIs to take up sanitation promotion. The award is given to those PRIs that attain a 100 per cent open defecation-free environment.

URBAN INFRASTRUCTURE

To provide better urban infrastructure, housing and sanitation in the country, the central government has been allocating resources to state governments through various centrally sponsored schemes and providing finances through national financial institutions in the country. Some of the initiatives in this area are the following:

Jawahar Lal Nehru National Urban Renewal Mission (JNNURM)

The JNNURM has two of its four components devoted to shelter and basic service needs of the poor. These are: Basic Services to the Urban Poor (BSUP) for 65 select cities and Integrated Housing & Slum Development Programme (IHSDP) for other cities and towns. All states are covered under the BSUP and all states and UTs except Lakshadweep under the IHSDP.

Rajiv Awas Yojana (RAY)

RAY is to provide support for shelter and redevelopment and creation of affordable housing stock to states that are willing to assign property rights to slum dwellers. RAY is to be implemented in two phases: Phase I, which will be for two years from the date of approval of the scheme (2011-13) and Phase II which will be for the remaining period of the Twelfth Five Year Plan (2013-17). The preparatory phase of RAY is named the *Slum Free City Planning Scheme*. In order to address the credit enablement of economically weaker section (EWS) and lower income group (LIG) households, the government has agreed to establish a Credit Risk Guarantee Fund under RAY. The government has also approved the establishment of a Credit Risk Guarantee Fund Trust for low income housing (CGFT) to administer and oversee the operations of the scheme.

Affordable Housing in Partnership (AHIP)

The government has launched the AHIP scheme with the aim of constructing of one million houses forn EWS/LIG/MIG with at least 25 per cent reserved for the EWS category. The scheme aims at partnership between various agencies/government/parastatals/urban local bodies/developers for realising the goal of affordable housing for all.

Interest Subsidy Scheme for Housing the Urban Poor (ISHUP)

The ISHUP seeks to supplement the efforts of the government through the JNNURM to comprehensively address the housing shortage by providing subsidies on the bank loans forwarded for the housing to urban poor.

Integrated Low Cost Sanitation Scheme (ILCS)

The ILCS aims at conversion of individual dry latrines into pour flush latrines, thereby liberating manual scavengers from the age-old, obnoxious practice of manually carrying night soil. The guidelines were revised with effect from January 17, 2008. The scheme is on an all-town coverage basis irrespective of the population criterion and is limited to EWS households. The scheme is funded on a sharing basis, i.e., central subsidy 75 per cent, state subsidy 15 per cent, and beneficiary

share 10 per cent.

SKILL DEVELOPMENT

Education and skill development play a pivotal role in economic development and growth of any country as they provide an environment for creating jobs and help in reduction of poverty and other related social fallouts. A new strategic framework for skill development for early school leavers and existing workers has been developed since ***May 2007*** in close consultation with industry, state governments, and experts.

Achievements of the National Skill Development Corporation (NSDC) upto December 2012 (in 2012-13) has been as given below –

- Approved 24 training projects for imparting skill training in a *wide array of sectors* like – healthcare; tourism; hospitality and travel; banking, financial services and insurance (BFSI); retail; IT; electronics; textiles; leather; handicrafts and automotive; agriculture, cold chains and refrigeration; tailoring; carpentry and masonry.
- Besides formation of skill councils for seven sectors, proposals related to food processing, telecom, agriculture, plumbing, logistics, capital goods, and construction sectors have also been approved during this period.
- With its partners it had skilled around 1,39,305 people and placed approximately 97,116 of them, thereby achieving ***placement of 70 per cent***.
- Special skills training initiatives of the NSDC have been helping youth in Jammu and Kashmir and the north-eastern states join the mainstream. The NSDC has been able to get some of India's biggest corporate groups interested in the private sector-led skills training programme for graduates and post-graduates in Jammu and Kashmir called *Udaan*. Scaling up of this initiative is targeted to make 40,000 people in Jammu & Kashmir skilled and placed in jobs over a five-year span. In the north-east region, the NSDC is partnering the Ministry of Youth Affairs and Sports in the Youth Employability Skills *(YES)* project.

Union Budget 2013-14 announced that youth will be motivated to voluntarily join skill development programmes – National Skill Development Corporation to set the curriculum and standards for training in different skills for which Rs. 1,000 crore has been set apart for 2013-14. The GoI has set a target of skilling *50 million* people in the ***12th Plan***, including *9 million* in 2013-14 (BE).

UIDAI

After successfully completing Phase I enrolments, the UIDAI (Unique Identification Authority Of India) is actively engaged in Phase II in which 40 crore residents are to be enrolled before end 2014.

As of December 2012, 24.93 crore Aadhaars had been generated and approximately 20 crore Aadhaar letters dispatched. The UIDAI has also established infrastructure to generate 10 lakh Aadhaars per day and process 10 million authentication transactions a day. Apart from meeting targets related to enrolments, significant amount of effort has been spent on enabling service delivery of government schemes with Aadhaar online authentication and Aadhaar-enabled benefits transfers to

bank accounts of beneficiaries. The government has decided to initiate direct transfer of subsidy under various social schemes into beneficiaries' bank accounts. The transfer will be enabled through a payments bridge known as Aadhaar Payment Bridge (APB) wherein funds can be transferred into any Aadhaar-enabled bank account on the basis of the Aadhaar number. This eliminates chances of fraud/error in the cash transfer process. The Aadhaar number will be linked to the beneficiary database so that ghosts/ duplicates are weeded out from the beneficiary list.

To make withdrawal of money by the beneficiaries easier and more accessible and friendly, micro ATMs will be set up by banks/ post offices throughout the country in an open manner particularly with the help of SHGs, community service centres (CSCs), post offices, grocery stores, petrol pumps, etc. in rural areas and accessible pockets. This is being done initially in 51 pilot districts across the country from January 1, 2013. Pilots on direct benefit transfer (DBT) have also been successfully conducted in the states of Jharkhand, Tripura, and Maharashtra to transfer monetary benefits related to rural employment, pension, the IAY, and other social welfare schemes. An important pilot is the fair price shops in East Godavari and Hyderabad districts of Andhra Pradesh which are being enabled to carry out online Aadhaar authentication. In another important pilot with oil marketing companies (OMCs) in Mysore, delivery of LPG gas cylinders is being done only after Aadhaar online authentication of customers.

EDUCATION

India which had a bottom-heavy population is now graduating to an economy with middle- heavy population. To reap the benefits of this demographic dividend to the full, India has to provide education to its population through quality education. The Twelfth Plan Approach Paper focuses on teacher training and evaluation and measures to enforce accountability. It also stresses the need to build capacity in secondary schools to absorb the pass- outs from expanded primary enrolments. The GER in higher education must be targeted to increase from nearly 18 per cent at present to say 25 per cent by 2016-17.

Elementary and Secondary Education 13.30The government has initiated many schemes for elementary and secondary education. Some are as follows:

Sarva Shiksha Abhiyan (SSA)/Right to Education (RTE)

Free education for all children between the ages of 6 and 14 years has been made a fundamental right under the RTE Act 2009. While the RTE Act was notified on 27 August 2009 for general information, the notification for enforcing the provisions of the Act with effect from April 1, 2010 was issued on February 16, 2010. It mandates that every child has a right to elementary education of satisfactory and equitable quality in a formal school which satisfies certain essential norms and standards. The reform processes initiated in 2010-11 continued during the year 2011-12. Some recent developments in this regard include:

(i) Notification of Central RTE Rules on 8 April 2010, followed by notification of State RTE Rules by the states,

(ii) Revision of the SSA norms to correspond with the provisions of the RTE Act including norms for sanctioning additional teacher posts, classrooms, teaching-learning equipment to enable

states to move to an eight-year elementary education cycle, enhancement of academic support for better school supervision, and expansion of Kasturba Gandhi Balika Vidyalayas (KGBVs),

(iii) Revision of the fund- sharing pattern between the central and state governments for implementation of RTE-SSA programme from the earlier pattern in the sliding scale to a 65:35 ratio between the centre and states for a five-year period from 2010-11 to 2014-15,

(iv) Notification of the National Council for Teacher Education (NCTE) as the academic authority for laying down teacher qualifications,

(v) Launching of a country-wide campaign for raising public awareness about the RTE and mobilising communities to ensure that all schools become RTE compliant.

National Programme for Education of Girls at Elementary Level (NPEGEL)

This is a focused intervention for reaching out to the hardest to reach girls. It provides additional support for enhancing girls' education over and above the investments for girls' education under the SSA, including gender sensitisation of teachers, development of gender-sensitive material, and provision of need-based incentives. The scheme is implemented in educationally backward blocks (EBB) where rural female literacy is low.

National Programme of Mid Day Meals in schools

Under the National Programme of Mid Day Meals in schools, cooked midday meals are provided to all children attending Classes I-VIII in government, local body, government-aided, and National Child Labour Project schools. EGCs/alternate and innovative education centres including madarsas/maqtabs supported under the SSA across the country are also covered under this programme. At present, the cooked midday meal provides an energy content of 450 calories and protein content of 12 grams at primary stage and an energy content of 700 calories and protein content of 20 grams at upper primary stage. Adequate quantity of micro-nutrients like iron, folic acid, and vitamin A are also recommended for convergence with the NRHM.

Rashtriya Madhyamik Shiksha Abhiyan (RMSA)

The RMSA was launched in March 2009 with the objective of enhancing access to secondary education and improving its quality. In addition to ensuring access, the quality interventions include ensuring all secondary schools conform to prescribed norms, removing gender, socio-economic and disability barriers, providing universal access to secondary level education by 2017, i.e., by the end of the Twelfth Five Year Plan, and achieving universal retention by 2020. The Central and State governments bear 75 per cent and 25 per cent of the project expenditure respectively during the Eleventh Five Year Plan. The funding pattern is in the ratio of 90:10 for the north-eastern states.

Model Schools Scheme

A scheme for setting up 6000 model schools as benchmarks of excellence at block level with one school per block was launched in November 2008 with a view to providing quality education to talented rural children. The scheme has two modes of implementation:

(i) 3500 schools are to be set up in as many Educationally Backward Blocks (EBBs) through state/UT governments and

(ii) The remaining 2500 schools are to be set up under PPP mode in blocks that are not educationally backward.

At present, only the first component is being implemented. The implementation of the PPP component will start from Twelfth Five Year Plan. Since the inception of the scheme, approval has been granted for setting up 1942 model schools in 22 states.

Inclusive Education for the Disabled at Secondary Stage (IEDSS)

The IEDSS scheme was launched in 2009-10 replacing the earlier Integrated Education for Disabled Children (IEDC) scheme. While inclusive education for disabled children at elementary level is being provided under the SSA, this scheme provides 100 per cent central assistance for inclusive education of disabled children studying in Classes IX-XII in mainstream government, local body, and government-aided schools. The aim of the scheme is to facilitate continuation of education of children with special needs up to higher secondary level. The scheme provides for personal requirements of the children in the form of assistive devices, helpers, transport, hostel, learning material, and scholarship for the girl child up to Rs. 3,000 per disabled child per annum. In addition, assistance is also provided for salary of special teachers, capacity building of teachers, making schools barrier free, establishment of resource rooms, and awareness and orientation.

Vocational Education

The revised centrally sponsored Vocationalisation of Secondary Education scheme aims to address the weaknesses of the earlier scheme to strengthen vocational education in Classes XI-XII. The components approved for implementation in the remaining period of the Eleventh Plan, i.e., 2011-12, include:

- (i) Strengthening of 1,000 existing vocational schools and establishment of 100 new ones through state governments;
- (ii) Assistance to 500 vocational schools under the PPP mode;
- (iii) In-service training of seven days for 2,000 existing vocational teachers and induction training of 30 days for 1,000 new ones;
- (iv) Development of 250 competency based modules for each individual vocational course;
- (v) Establishment of a vocational education cell within the Central Board of Secondary Education (CBSE);
- (vi) Assistance to 150 reputed NGOs to run short-duration innovative vocational education programmes; and
- (vii) Pilot programme under the National Vocational Education Qualifications Framework (NVEQF) in Class IX in Haryana and West Bengal.

Saakshar Bharat/Adult Education

The National Literacy Mission, recast as *Saakshar Bharat* (SB) launched by the Prime Minister on September 8, 2009, reflects the enhanced focus on female literacy. The literacy rate according to the 2001 census was 64.83 per cent, improving to 74.04 per cent in 2011.

The literacy rate improved sharply among females as compared to males. While the literacy rate for males rose by 6.9 per cent from 75.26 per cent to 82.14 per cent, it increased by 11.8 per cent for females from 53.67 per cent to 65.46 per cent. The target of the Eleventh Five Year Plan is to achieve 80 per cent literacy. With just one year to go for the Twelfth Five Year Plan, 74 per cent literacy has been achieved. Literacy levels remain uneven across states, districts, social groups, and minorities. Since the Mission has been envisaged as a people's programme, stakeholders, especially at

grassroots level, have due say and role in its planning and implementation. The decentralised model of the Mission provides PRIs a pivotal role in implementation of the programme at district level.

Annual Status of Education Report (ASER) 2012

The *ASER-2012* was released on *Jnauary 17, 2013* – we may have a look in two parts:

I. Positives Changes or Status Quo

Rising enrollment: In 2012, 96.5 per cent of all 6-14 year olds in rural India are enrolled in schools. This is the fourth consecutive year that enrollment levels have been 96 per cent or more. In 2006, in eight major states, more than 11 per cent girls in the age group of 11 to 14 years were not enrolled in school. By 2011, this figure had dropped to less than 6.5 per cent in 3 of these states (Jharkhand, Gujarat and Odisha) and less than 5 per cent in 3 others (Bihar, Chhattisgarh and West Bengal).The situation in these states remained more or less unchanged in 2012. However in Rajasthan and Uttar Pradesh, the proportion of out of school girls (age 11-14) has increased from 8.9 per cent and 9.7 per cent respectively in 2011 to more than 11 per cent in 2012.

Private school enrollment is rising in most states: Private school enrollment of 6 to 14 year olds has risen steadily since 2006 from 18.7 per cent in 2006 to 28.3 per cent in 2012. Increase in private school enrollment is seen in almost all states, with the exception of Kerala, Nagaland, Manipur, Meghalaya and Tripura (where private school enrollment was over 40 per cent even last year). There was of more than 40 per cent enrollment in Jammu & Kashmir, Punjab, Haryana, Rajasthan, Uttar Pradesh and Meghalaya in private schools. This percentage is 60 per cent or more in Kerala and Manipur. Since 2009, private school enrollment in rural areas has been rising at an annual rate of about 10 per cent. If this trend continues, by 2018 India will have 50 per cent children in rural areas enrolled in private schools.

Better provision of girls' toilets: The proportion of schools without toilets (girls + boys) has fallen from 12.2 per cent in 2011 to 8.4 per cent in 2012. The proportion of schools having toilets usable separately by girls has improved from 32.9 in 2011 to 48.2 percent in 2012.

More libraries in schools and more children using them: The proportion of schools without libraries has declined from 28.7 per cent in 2011 to 23.9 percent in 2012. Children were seen using the library in more schools as well–up from 37.9 per cent in 2010 to 43.9 per cent in 2012.

Compliance on pupil-teacher ratio and Classroom-Teacher ratio: At the All India level, there has been a consistent rise in the proportion of schools complying with RTE norms on pupil-teacher ratio, from 38.9 per cent in 2010 to 42.8 percent in 2012. In 2012, Nagaland stands out with 93.0 per cent of schools in compliance ahead of Kerala (92.0 percent) which was the highest last year. In Jammu & Kashmir, Mizoram, Manipur and Tripura, more than 80 per cent schools are in compliance with these norms.

No major changes in buildings, playgrounds, boundary walls or drinking water: About 61.1 per cent of visited schools had a playground in 2012 compared to 62.8 percent in 2011. However, there has been marginal increase of 0.8 percent in the proportion of all schools that have a boundary wall in 2012 from the last year. Nationally, the proportion of schools with no provision for drinking water remained almost the same at 17 per cent in 2010, 16.7 per cent in 2011 and 16.6

percent in 2012. The proportion of schools with a useable drinking water facility has remained steady at about 73 per cent.

II. Negative Changes

Classroom Teacher ratio is declining: There has been a decline in the proportion of schools with at least one classroom per teacher, from 76.2 per cent in 2010 to 74.3 per cent in 2011 and further to 73.7 percent in 2012. However, departing from the national pattern, in states like Bihar, Chhattisgarh, Haryana, Himachal Pradesh, Kerala, Maharashtra, Meghalaya, Nagaland, Tamil Nadu, Tripura, Uttarakhand and West Bengal there has been an increase in teacher classroom ratio this year.

Declining basic reading levels: In 2010, 46.3 per cent of all children in std V could not read a std II level text, which has increased to 52.3 percent in 2012.

Arithmetic levels also show a decline across most states: Basic arithmetic levels estimates show a decline. For example, nationally, 29.1 per cent of Std V children could not solve simple two digit subtraction problem with borrowing in 2010 which increased to 39 per cent in 2011 and further to 46.5 per cent in 2012. Barring Andhra Pradesh, Karnataka and Kerala, every major state shows signs of substantial drop in arithmetic learning levels.

Children's attendance has declined: Children's attendance (for std I-V) shows a decline from 74.3 per cent in 2009 to 71.3 per cent in 2012 in rural primary schools. However, children's attendance in some states shows an increase over time. For example, in primary schools of Bihar, average attendance of children increased from 57.0 per cent in 2007 to 58.3 per cent in 2012, in Karnataka from 88.0 per cent in 2009 to 89.1 per cent in 2012, in Kerala it has increased from 91.9 percent in 2009 to 94.4 percent in 2012 and in Odisha from 74.1 per cent in 2009 to 77.5 per cent in 2012.

More than half of all Std 2 and Std 4 classes sit together with another class: Nationally, in rural government primary schools, students who sit in multi-grade classrooms is rising.

Higher and Technical Education

With the intention of allocating higher amount of funds for primary and secondary education, the central government did put the higher education in the non-priority sector in the era of economic reforms.[4] Though the governmental committment for the development of the sector has not diminished and has taken a new and practical orientation, in future the private sector resources will be harnessed for its proper development.[5] An important challenge in the higher education sector is to bring about reforms not only in the institutions of higher learning but also in the regulatory structures of the higher education system. There are also the challenges of maintaining quality and excellence while ensuring rapid expansion and attracting and retaining good faculty in adequate numbers to meet the demands of the rapidly expanding sector.

The higher education system of India is one of the largest in the world in terms of the number of colleges and universities. While at the time of Independence, there were only 20 universities and 500 colleges with 0.1 million students, their number has increased to ***690*** universities and university-level institutions and 35,539 colleges – of the 690 universities, 44 are central universities, 306 state

universities, 145 state private universities, 130 deemed universities, 60 institutes of national importance plus other institutes, and 5 institutions established under State Legislature Acts, as per the latest *Economic Survey 2012-13*.

A number of initiatives[6] have been taken during the *Eleventh Plan* period with focus on improvement of access along with equity and excellence, adoption of state-specific strategies, enhancing the relevance of higher education through curriculum reforms, vocationalization, networking, and use of IT and distance education along with reforms in governance in higher education – major ones are as given below:

- 16 central universities were established which include conversion of three state universities to central universities. Seven new Indian Institutes of Management (IIMs), 8 new Indian Institutes of Technology (IITs), 10 new National Institutes of Technology (NITs), 5 Indian Institutes of Science Education & Research (IISERs), and 2 Schools of Planning and Architecture (SPAs) were also established.
- The National Mission on Education through ICT (NMEICT) which ***aims*** at "providing high speed broadband connectivity to universities and colleges and development of e-content in various disciplines" is under implementation. The low cost access-cum-computing device ***Aakash 2*** was launched in *November 2012*.
- A Scheme of *Interest Subsidy on Educational Loans* to economically weaker sections (EWS) students was introduced from 2009-10.
- An Expert Group was set up by the Prime Minister in order to suggest ways of enhancing employment opportunities in Jammu and Kashmir and to formulate job plans *involving the public and private sectors*. Among the key recommendations of the Expert Group, one is offering scholarships over the next five years, to encourage the youth of Jammu and Kashmir to pursue higher studies outside the state – being implemented since 2011-12.
- To address the increasing *skill challenges* of the Indian IT industry, the government has approved setting up of 20 new Indian Institutes of Information Technology (IIITs) on ***PPP basis*** – to be completed in *nine years* from 2011-12 to 2019-20.

HEALTH

With the National Population Policy, 2000 the idea of family welfare and population control have gone for major shift in the approach. Now, the government thinks that once the living conditions and awareness of the masses are improved, the population will be automatically controlled. Due to this also factors such as nutrition, drinking water, healthcare, education, shelter, social welfare and social security measures, etc. are given due care. The implementation of the social sector related areas in an integrated manner is supposed to have an inherent impact on the matter of population control.[7]

The National Health Policy of 2002 and the priorities set in the successive Five year Plans provide the framework for the implementation of policies and programmes for health care. The National Health Policy seeks to provide prophylactic and curative health-care services and aims at achieving an acceptable standard of good health amongst the general population in the country by increasing access to the decentralised public health system.

Access to the decentralised public health system is sought to be increased through establishment of new infrastructure in deficient areas and upgrading of existing infrastructure. Success in eliminating or controlling diseases such as small pox, leprosy, polio, and TB is indicative of the progress made in some areas of health. Overall sex ratio in the country has increased from 933 in 2001 to 940 as per **Census 2011**. Despite progress made on many fronts, there are areas of concern as progress has been quite uneven across regions with large-scale inter-state variations and rural and remote areas continue to have deficit in health facilities and manpower.

HUNGaMA Survey[8]

A reduction in the prevalence of child malnutrition is observed: Prevalence of child underweight has decreased from 53 per cent to 42 per cent; this represents a 20.3 per cent decrease over a 7 year period with an average annual rate of reduction of 2.9 per cent.

Child malnutrition is widespread across states and districts and starts early in life: 42 per cent of children under five are underweight and 59 per cent are stunted. Of the children suffering from stunting, about half are severely stunted; about half of all children are underweight or stunted by age 24 months.

Birth weight is an important risk-factor for child malnutrition: Prevalence of underweight in children born with a weight below 2.5 kg is 50 per cent while that among children born with a weight above 2.5 kg is 34 per cent.

Household socio-economic status has a significant effect on children's nutrition status: Prevalence of malnutrition is significantly higher among children from low-income families. Children from Muslim or SC/ST households generally have worse nutrition indicators.

Girls' nutrition advantage over boys fades away with time: Nutrition advantage girls have over boys in the first months of life seems to be reversed over time as they grow older, potentially indicating neglect vis-à-vis girls in early childhood.

Mothers' education level determines children's nutrition: Prevalence of child underweight among mothers who cannot read is 45 per cent while that among mothers with 10 or more years of education is 27 per cent; 92 per cent mothers had never heard the word 'malnutrition'.

Giving colostrum to the newborn and exclusive breastfeeding for first 6 months of a child's life are not commonly practiced: 51 per cent of the mothers did not give colostrum to the newborn soon after birth and 58 per cent mothers fed water to their infants before 6 months.

Hand washing with soap is not a common practice: 11 per cent mothers said they used soap to wash hands before a meal and 19 per cent do so after a visit to the toilet.

Anganwadi Centres are widespread but not always efficient: There is an Anganwadi Centre in 96 per cent of the villages, 61 per cent of them in pucca buildings; the Anganwadi service accessed by the largest proportion of mothers (86 per cent) is immunization; 61 per cent of Anganwadi Centres had dried rations available and 50 per cent provided food on the day of survey; only 19 per cent of the mothers reported that the Anganwadi Centre provides nutrition counseling to parents.

The government has launched a large number of programmes and schemes to address major concerns

and bridge the gaps in existing health infrastructure and provide accessible, affordable, equitable health care. These include the NRHM, National Programme for Health Care of the Elderly (NPHCE), National Mental Health Programme, NPCDCS, Pradhan Mantri Swasthya Suraksha Yojana (PMSSY), upgradation/strengthening of state government medical colleges, development of paramedical services and the Programmes of AYUSH. The details of major programmes are as follows:

NRHM (National Rural Health Mission)

The NRHM launched in 2005 aims to improve accessibility to quality health care for the rural population, bridge gaps in health care, facilitate decentralised planning in the health sector and bring about inter-sectoral convergence. The NRHM provided an overarching umbrella to the existing health and family welfare programmes including Reproductive and Child Health (RCH-II) and various programmes for control of diseases, including tuberculosis, leprosy, vector-borne diseases and blindness. The effort is to integrate all vertical programmes. All the programmes have now been brought under the District Health Society at district level and State Health Society at state level. Some of the weaknesses identified in the health delivery system in the public sector are poor upkeep and maintenance and high absenteeism of manpower in rural areas. The NRHM seeks to strengthen the public health delivery system at all levels.

Reproductive and Child Health (RCH)

The RCH Programme was launched in 1997-98 as a separate entity up to the year 2004-05 as a part of the Family Welfare Programme and was brought under the ambit of the NRHM during the Eleventh Plan. It has components such as pulse polio immunisation and routine immunisation for protection of children from life threatening conditions that are preventable such as tuberculosis, diphtheria, pertussis, tetanus, polio, and measles.

Janani Suraksha Yojana (JSY)

The JSY was launched with focus on demand promotion for institutional deliveries in states and regions where these are low. It integrates cash assistance with delivery and post-delivery care. It targets lowering of MMR by ensuring that deliveries are conducted by skilled birth attendants. The JSY scheme has shown rapid growth in the last three years, with 90.37 lakh beneficiaries in 2008-09 to 106.96 lakh beneficiaries in 2010-11. The issues of governance, transparency, and grievance redressal mechanisms are now the thrust areas for the JSY.

Janani Shishu Suraksha Karyakram (JSSK)

The JSSK is a new initiative launched on 1 June 2011 to give free entitlements to pregnant women and sick new borns for cashless delivery, C-Section, drugs and consumables, diagnostics, diet during stay in the health institutions, provision of blood, exemption from user charges, transport from home to health institutions, transport between facilities in case of referral, and drop back from Institutions to home. In order to reach out to difficult, inaccessible, backward and under-served areas with poor health indicators, 264 high focus districts in 21 states have been identified based on concentration of SC/ST population and presence of left wing extremism for focused attention. A Mother and Child Tracking System has been introduced, which provides complete data of the mothers with their addresses, telephone numbers, etc. for effective monitoring of ante-natal and post-natal check-up of mothers and immunisation services.

National Vector Borne Disease Control Programme

This Programme is being implemented for prevention and control of vector-borne diseases such as malaria, filariasis, kala-azar, Japanese encephalitis, dengue, and chikungunya.

Revised National Tuberculosis Control programme (RNTCP)

The RNTCP, a centrally sponsored ongoing scheme, is an application in India of the WHO-recommended directly observed treatment short course popularly known as DOTS. Under the programme, quality diagnosis and treatment facilities including a supply of anti-TB drugs are provided free of cost to all TB patients. More than 13,000 microscopy centres have been established in the country. During 2010-11, the programme has achieved new sputem positive case detection rate of 71 per cent and treatment success rate of 87 per cent which is in line with global argets for TB control.

National Leprosy Eradication Programme (NLEP)

The NLEP was started in 1983 with the objective of eradication of the disease. In 2005, the dreaded disease after 22 years recorded a case load less than 1 per 10,000 population at national level. The recorded prevalence further came down to 0.65 per 10,000 in March 2012.

National Programme for Control of Blindness (NPCB)

The NPCB, launched in the year 1976 as a 100 per cent centrally sponsored scheme with the goal of reducing the prevalence of blindness to 0.3 per cent by 2020, showed reduction in the prevalence rate of blindness from 1.1 per cent (2001-02) to 1 per cent (2006-07).

National Programme for Health Care of the Elderly (NPHCE)

The NPHCE aims to provide separate and specialized comprehensive health care to senior citizens at various levels of the state healthcare delivery system including outreach services. Some of the strategies include preventive and promotive care, management of illness, health manpower development for geriatric services, medical rehabilitation, and therapeutic intervention and Information Education and Communication (IEC) activities. The major components of the NPHCE are establishment of 30 bedded departments of geriatrics in 8 identified regional medical institutions, and provision of dedicated health-care facilities at district, CHC, PHC and sub-centres levels in 100 identified districts of 21 states of the country.

NPCDCS

The NPCDCS was launched during the Eleventh Five year plan. It envisages health promotion and health education advocacy, early detection of persons with high levels of risk factors through opportunistic screening and strengthening of health systems at all levels to tackle Non Communicable Disease (NCDs), and improvement of quality of care. At present the programme is being implemented in 100 districts covering 21 states.

Human Resources and Infrastructure Development in Tertiary Health Care

The Eleventh Plan also witnessed a number of initiatives to improve the availability of human resources in the health sector. With a view to strengthening government medical colleges, the land requirement norms and infrastructural requirements for opening new medical colleges have been revised. The faculty requirements have also been revised. Besides, increased intake at MBBS level has been enabled especially in the under-served states.

PMSSY

The PMSSY has been launched with the objectives of correcting regional imbalances in the

availability of affordable/reliable tertiary health-care services and augmenting facilities for quality medical education in the country. These are sought to be achieved through establishing AIIMS-like institutions and upgrading existing medical college institutions. The PMSSY aims at

(i) Construction of 6 AIIMS like institutions in the first phase at Bhopal, Bhubaneswar, Jodhpur, Patna, Raipur, and Rishikesh and in the second phase in West Bengal and Uttar Pradesh, and

(ii) Upgradation of 13 medical college institutions in the first phase and 6 in the second phase.

The upgradation programmes broadly envisages improving health infrastructure through construction of super speciality blocks/trauma centres, etc. and procurement of medical equipment for existing as well as new facilities. Seven more medical colleges are proposed to be upgraded, one each in Kerala, Karnataka and Madhya Pradesh and two each in Bihar and Uttar Pradesh in the third phase.

Upgradation/Strengthening of State Government Medical Colleges

This is a centrally sponsored scheme for strengthening /upgradation of state government medical colleges. The scheme envisages a one-time grant of Rs. 1350 crore to be funded by central and state governments in the ratio of 75:25. During 2009-10 to 2011-12, 70 medical colleges have been funded.

Ayurveda, Yoga & Naturopathy, Unani, Siddha and Homeopathy (AYUSH)

Mainstreaming of AYUSH in national health care delivery is an important goal under the NRHM. A new component of upgradation of AYUSH dispensaries has been incorporated in the centrally sponsored scheme of Development of AYUSH Hospitals and Dispensaries in July 2010. Besides, a component of setting up of 50/10 bedded integrated AYUSH hospitals for North Eastern and other hilly states has been introduced in 2011.

WOMEN AND CHILD DEVELOPMENT

The Government of India pursues a three dimensional strategy for development of women, namely ***social empowerment, economic empowerment*** and ***gender justice*** which is to be continued with in the 12th Plan, too.[9] The government has started several schemes and initiated many new policy initiatives for the welfare and development of women and children which also include initiatives for economic and social empowerment of women and securing gender equality in various aspects of social, economic, and political life. The scope and coverage of the schemes for women and child development have been expanding under various Plans.

Women lag behind men in many social indicators like health, education and economic opportunities. Hence they need special attention due to their vulnerability and lack of access to resources. Since national budgets impact men and women differently through the pattern of resource allocation, the scope and coverage of schemes for women and child development have been expanded with progressive increase in Plan expenditure under various Plan schemes, increased employment for women under the MGNREGA and *gender budgeting* (GB).[10] The allocations for GB as a percentage of total budget have gone up from **2.79** per cent in 2005-06 to **5.91** per cent in 2012-13. Some of the important schemes and policy initiatives for economic and social empowerment of women and child development are as follows –

Integrated Child Development Services (ICDS) Scheme

The *objective* of the ICDS scheme is holistic development of children below 6 years of age and proper nutrition and health education of pregnant and lactating mothers starting with 33 projects and 4891 anganwadi centres (AWCs) in 1975.

This has now been *universalized* with cumulative approval of 7076 projects and 14 lakh AWCs including 20,000 anganwadis 'on-demand'. A proposal for strengthening and restructuring of the ICDS Scheme (with an overall budget allocation of Rs. 1,23,580 crore) during the Twelfth Plan has been approved. Greater emphasis is being laid on awareness generation, *convergence* with the MGNREGA, and MIS-based monitoring.

Rajiv Gandhi Scheme for Empowerment of Adolescent Girls (RGSEAG)-Sabla

Sabla now operational in *205 selected districts* aims at "all-round development of adolescent girls" in the age group 11-18 years and making them *self-reliant* with a special focus on "out-of-school" girls. The scheme has two major components, nutrition and non-nutrition. Nutrition is being given in the form of 'take home rations' or 'hot cooked meals' to out-of-school 11-14 year old girls and all adolescent girls in the 14 -18 age group. The non-nutrition component addresses the developmental needs of 11-18 year old adolescent girls who are provided *iron-folic acid* supplementation, health check-up and referral services, nutrition and health education, counseling/guidance on family welfare, skill education, guidance on accessing public services, and vocational training. The target of the scheme is to provide nutrition to 1 crore adolescent girls in a year.

Indira Gandhi Matritva Sahyog Yojana (IGMSY)

The IGMSY is a *conditional cash transfer scheme* for 'pregnant and lactating women' implemented initially on *pilot* basis in 53 selected districts in the country from October 2010. The scheme is now covered under the *Direct Benefit Transfer (DBT)* programme with nine districts being included in the first phase.

National Mission for Empowerment of Women (NMEW)

This initiative for *holistic empowerment* of women through better convergence and engendering of policies, programmes, and schemes of different ministries was operationalized in 2010-11. Under the Mission, institutional structures at state level including State Mission Authorities headed by Chief Ministers and State Resource Centres for Women (SRCWs) for spearheading initiatives for women's empowerment have been established across the country.

Rashtriya Mahila Kosh (RMK)

The RMK provides 'micro-credit' in a quasi-informal manner, lending to intermediate micro-credit organisations (IMOs) across states – was launched in 1993. It *focuses* on poor women and their empowerment through the provision of credit for livelihood-related activities.

Policies to address Violence Against Women

Addressing violence against women is another area which has received a lot of *recent attention*. Following the recent tragic incident of sexual assault in New Delhi, a committee of eminent jurists, headed by former Chief Justice of India *Justice J. S. Verma,* was constituted to review existing laws and examine levels of punishment in cases of aggravated sexual assault and it has submitted its recommendations.

An *Ordinance* has also been issued on sexual assault against women [Criminal Law (Amendment)

Ordinance, 2013] based on the recommendations of the Justice Verma Committee. A Commission of Inquiry was also set up under the Chairpersonship of *Ms Justice Usha Mehra*, retired Judge of Delhi High Court to identify lapses on the part of public authorities and suggest measures to improve the safety and security of women in the capital.

New initiatives are being taken like 'one-stop crisis centres' for providing shelter, police assistance, legal, medical and counselling services with public hospitals as focal point. A scheme for providing restorative justice through financial assistance and support services to victims of rape will be implemented in the *Twelfth Plan* as per the directives of the Supreme Court of India.

Nirbhaya Fund

The *Union Budget 2013-14* announced setting up of a *Nirbhaya Fund* with a GoI contribution of Rs. 1,000 crores for *empowerment, safety* and *security* of women and girl children.

Welfare and Development of SCs, STs, OBCs and Other Weaker Sections

As part of the strategy to achieve inclusive development, the government is committed to the economic and social empowerment and educational upliftment of socially disadvantaged groups and marginalised sections of society.[11] Accordingly, such programmes are implemented through states, government's apex corporations and NGOs. The PPP approach is also being explored for effective delivery of services with more accountability and transparency.

Scheduled Castes (SCs)

A number of schemes to encourage SC students to continue their studies from school to higher education level as well as for the economic advancement of needy SC families are under implementation. The Post-Matric scheme has been revised with effect from July 1, 2010 so as to:

(i) Raise the parental annual income ceiling for eligibility from Rs. 1 lakh to Rs. 2 lakh,

(ii) Rationalise the grouping of courses, and

(iii) Upwardly revise maintenance and other allowances by 60 per cent.

Under the Rajiv Gandhi National Fellowship Scheme which aims at providing financial assistance to SC students pursuing M. Phil and PhD courses, the number of scholarships. The specified subjects under National Overseas Scholarships have been revised for the selection year 2010-11 and new subjects, namely medicine, pure sciences, engineering, agricultural sciences, and management have been specified for providing financial assistance to students pursuing master's-level courses and PhD/post-doctoral courses abroad.

The Scheme of Top Class Education for SCs provides financial assistance for quality education to SC students up to degree/post-degree level. SC students who secure admission in notified institutions are awarded scholarships. Twenty-four new institutions have been added to the notified list of premier institutions under the scheme with effect from the current financial year. The total number of specified institutions has thus increased to 205. Under the revised Babu Jagjivan Ram Chhatrawas Yojna,' a centrally sponsored scheme for hostels for SC boys and girls, assistance for the construction of girls hostels has been raised from 50 per cent to 100 per cent.

Special Central Assistance to the Scheduled Castes Sub Plan is a major scheme for economic

advancement of SCs. The main thrust is on economic development of the SC population in order to bring them above the poverty line through self-employment or training. The amount of subsidy admissible under the scheme is 50 per cent of the project cost, subject to a maximum of Rs. 10,000 per beneficiary.

Scheduled Tribes (STs)

The Special Central Assistance (SCA) to the Tribal Sub- Plan (TSP), is a 100 per cent grant extended to states as additional funding to their TSPs for family-oriented income-generating schemes, creation of incidental infrastructure, extending financial assistance to SHGs, community-based activities, and development of forest villages. Human Development funds are provided to states with the objective of promoting the welfare of STs and improving administration of scheduled areas in conjunction with other schemes/programmes. The Scheme for Post-Matric Scholarship with 100 per cent financial assistance to ST students whose family income is less than or equal to Rs. 2 lakh per annum for pursuing post-matric-level education including professional, graduate, and postgraduate courses in recognized institutions, the Scheme for Top Class Education for STs providing financial assistance for quality education to 625 ST students per annum to pursue studies at degree and post-degree levels in any of the 183 identified institutes, the National Overseas Scholarship Scheme with financial assistance to 15 eligible ST students for pursuing higher studies abroad in specified fields and the Scheme for Strengthening of Education among ST Girls in low literacy districts are some other schemes for the development of STs. Some measures for economic impowerment of STs include extension of financial support through the National Scheduled Tribes Finance and Development Corporation (NSTFDC) in the form of loans and micro-credit at concessional rates of interest for income-generating activities and in market development of tribal products and their retail marketing through its sales outlets by the Tribal Cooperative Marketing Development Federation of India Limited (TRIFED).

Other Backward Classes (OBCs)

The government provides central assistance to state governments/ UT administrations for educational development of OBCs. Under the revised Scheme of Post-Matric Scholarship for OBCs, it is proposed to provide scholarship to 17.25 lakh OBC students. in order to provide hostel facilities to OBC students studying in middle and secondary schools, colleges, and universities to enable them to pursue higher studies.

Minorities

Five communities-Muslims, Christians, Sikhs, Buddhists, and Parsis-notified by the government as minority communities constitute 18.42 per cent of total population as per the 2001 Census. The Eleventh Five Year Plan, a three pronged strategy including:

(i) Educational empowerment,

(ii) Area development, and

(iii) Economic empowerment of minority communities was adopted.

Educational empowerment was sought through three scholarship schemes, namely, Pre-matric, Post-matric, and Merit-cum-means based, with more than 1 crore scholarships. These schemes were supplemented by the activities of the Maulana Azad Education Foundation (MAEF). Economic empowerment is sought to be achieved through infusion of credit under priority-sector lending (PSL) by banks and through credit provided by the National Minorities Development and Finance Corporation (NMDFC). Efforts are also being made to improve the management of Wakf properties and a scheme for computerisation of Wakf Board records is a significant step in this direction. The Wakf Amendment Bill 2010 has also been introduced in Parliament to improve and streamline the functioning of Wakf Boards in India.

Persons with Disabilities

A number of schemes are being implemented for the empowerment and rehabilitation of **persons with disabilities**. These schemes aim to promote physical, psychological, social, educational, and economic rehabilitation and development of persons with disabilities to enhance their quality of life and enable them to lead their lives with dignity. There are seven autonomous national institutes working in different fields of disabilities. These institutes are engaged in human resource development in the field of disability, providing rehabilitation services to persons with disabilities and undertaking research and development in their respective areas of specialisations. Besides, in order to facilitate the creation of infrastructure and capacity building at the district level for awareness generation, rehabilitation, and training and guiding rehabilitation professionals, the central government with active support from state governments is providing comprehensive services to persons with disabilities through setting up of District Disability Rehabilitation Centers in all the unserved districts of the country. The scheme for setting up of DDRCs was initiated in Ninth Five Year Plan and is continuing in Eleventh Five Year Plan. Hundred new DDRCs were targeted to be set up during the last two years (2010-11 and 2011-12) of the Eleventh Five Year Plan.

Social Defence

Under the social defence sector, schemes/programmes are implemented for senior citizens and for victims of substance (drug) abuse.[12] Programmes for *senior citizens* aim at the welfare and maintenance especially of indigent senior citizens. For *victims* of substance abuse, drug demand reduction is achieved through awareness campaigns and treatment of addicts and their detoxification so that they may join the mainstream. Under the Integrated Programme for Older Persons (IPOP), grants-in-aid are given to NGOs for running old age homes (OAH), day care centres (DCCs), and mobile medical units (MMUs). The Maintenance and Welfare of Parents and Senior Citizens Act 2007 was enacted in order to ensure need-based maintenance for parents and welfare measures for senior citizens. States/ UTs are required to implement the Act by notifying the same in the official gazette. The Act has been notified by 23 states and all the UTs so far. Besides, grants-in-aid are provided to NGOs for running integrated rehabilitation centers for addicts, regional resource and training centers, and other projects. For effective implementation of social defence programmes, personnel engaged in delivery of services in this area are being trained under various programmes being organised by the National Institute of Social Defence (NISD).

There are also different financial institutions to further the cause of upliftment of the weaker sections of society. The National Scheduled Castes Finance and Development Corporation (NSCFDC), National Safai Karamcharis Finance and Development Corporation (NSKFDC), National Backward Classes Finance and Development Corporation (NBCFDC), and National Handicapped Finance and Development Corporation (NHFDC) provide credit facilities to their target groups at concessional rates of interest for various income-generating activities.

Comments of the Economic Survey 2012-13

The latest *Economic Survey 2012-13* has given its views on the Challenges & Prospects of Human Development in India in the following way –

- The global recession of 2008 and the recent global slowdown have *squeezed* the fiscal space for most countries and consequently the purse for social sector spending. However, India's social sector spending has seen a continuous increase even during these crisis-ridden years. India needs to balance the dual imperatives of growth and inclusion. This can happen only if growth leads to higher and better jobs. While the government's flagship programme, the MGNREGA, is intended to fill this ***'job deficit'*** in the interregnum, India has to focus on *longer-term inclusive growth strategies*.
- The $ 1 trillion Infrastructure opportunity is one such example. Even in the interregnum, schemes like the MGNREGA should move towards more production – and growth generating activities. The draft Twelfth Five Year Plan has emphasized faster, more inclusive, and sustainable growth. A special effort is needed in two areas of human development in India - health and education. These will help translate our *demographic advantage* into a real dividend *(see chapter 21)*. There is also need to address 'delivery-related' issues in a *mission mode* to ensure optimum utilization of funds and to convert ***outlays into outcomes***. For this, 'good governance' is critical.
- Coming to expenditure management, in the last few years, public expenditure on social rogrammes has increased dramatically from Rs. 9.10 lakh crore in the *Tenth Plan* period to Rs. 22.69 lakh crore during the *Eleventh Plan* period with a step up of over **149** per cent. In the Eleventh Plan period, nearly Rs. 7 lakh crore has been spent on the ***15 major flagship programmes*** – this sharp increase is 'unprecedented'.
- A number of legislative steps have also been taken to secure the *rights of people*, like the Right to Information Act, the MGNREGA, the Forest Rights Act, and the RTE. Thus the funds are in place, rights constitutionally guaranteed, and many achievements recorded, but there are also pressing issues like ***leakages*** and funds not reaching the targeted beneficiaries. While the Direct Benefit Transfer (DBT) system with the help of the UID can help in plugging many of these leakages, there is enough scope for expenditure reduction even in social-sector programmes through ***convergence*** (integration and combining).
- *Economic Survey 2011-12* had pointed out that there are many schemes like the AABY, JBY, and RSBY with significant overlap and catering to the same or similar categories of the population, with Shiksha Sahyoga Yojana (SSY) as a add-on benefit under the former two schemes. A welcome development this year is the merger of the JBY with the AABY. There

are many other such areas where convergence can take place. For example the JSY, Janani Shishu Surksha Karyakram (JSSK), and Indira Gandhi Matritva Sahyog Yojana (IGMSY) have many overlapping features and the same beneficiaries. This calls for a careful exercise in identifying overlapping schemes and weeding out or converging them.

- A *threshold level* could also be fixed for the schemes as a critical minimum investment or outlay is needed for any programme to be successful. The Committee *on 'Restructuring of Centrally Sponsored Schemes'* has suggested that new centrally sponsored schemes should have a minimum Plan expenditure of Rs. 10,000 crore over the Five Year Plan and should be included under *flagship schemes*.
- Another area needing attention is ***decentralisation***. While Plan programmes are designed with a "bottom-up approach" and are *Panchayat-and PRI-centric*, they are actually imsdplemented in a *top-down manner* and do not effectively articulate the needs and aspirations of the local people, especially the most vulnerable. With the 73rd Constitutional Amendment, several functions were transferred to PRIs and since 2004 there has also been massive transfer of funds to PRIs, especially after the enactment of the MGNREGA.

But institutionally the ***PRIs remain weak*** and do not have the required capacity to plan or implement programmes effectively. The *12th Plan* proposes a 'complete break from the past' and provides sizeable resources to the Ministry of Panchayati Raj. These higher outlays should be converted into *outcomes*. This calls for greater *focus on empowering PRIs* through training and awareness generation coupled with social audit of all social sector programmes. Cash transfers to the intended beneficiaries can also help empower citizens, even while giving them choice of provider. This too can help improve the quality of *service delivery*.

To the extent the GoI is concerned, the issues highlighted by the *Survey* are neither new nor un-attended. But the main thing is that in a democracy things can only move in the desired direction once there is required level of public awareness and participation in place – the things for which the PRI level planning was given Constitutional status by the Constitutional Amendments 73rd and 74th. It is a matter of time that the PRIs start functioning in their right mode and the dream of inclusive growth and development gets realised – we can work in this direction with all zeal.

Note to Sources: Analyses and comments articulated in this chapter are based on the notes and suggestions provided by some of the most noted economists and public policy-makers of India such as – Amartya Sen, ***Development as Freedom***, OUP, N. Delhi, 2000; Amartya Sen & Jean Dreze, ***Indian Development***, OUP, N. Delhi, 1996; Jeffrey D. Sachs, A. Varshney and Nirupam Bajpai, ***India in the Era of Economic Reforms***, OUP, N. Delhi, 1999, pp. 74–80; Kaushik Basu ed., ***India's Emerging Economy***, OUP, N. Delhi, 2004. & I.J. Ahhiwalia and I.M.D. Little (eds), ***India's Economic Reforms and Development***, OUP, N. Delhi, 1998; ***India Development Report 2004–05***, Oxford University Press, N. Delhi, 2005, pp. 40–61, 62–81, 96–111; Suresh D. Tendulkar & T.A. Bhavani, ***Understanding Reforms: Post 1991 India***, Oxford University Press, N. Delhi, 2007; various issue of the ***Economic Survey***, MoF, GoI, N. Delhi and ***The Twelfth Five Year Plan (2012-17): A Draft Outline***, Planning Commission, GoI, N. Delhi, 2011.

1. Amartya Sen, ***Development as Freedom,*** Oxford University Press, N. Delhi, 2000, pp. 3-11.
2. ***Economic Survey 1991–92*** to **2006–07**, MoF, GoI, N. Delhi.
3. **Economic Survey 1999-2000**, op. cit.
4. ***Economic Survey 1992–93,*** MoF, GoI.
5. ***Planning Commission*** in its full meeting, 17th September, 2007.
6. ***Economic Survey 2012-13***, op. cit., p. 285-287.
7. The ***Government of India*** articulated while the policy was announced quoting the experiences of the developed and some of the developing economies (such as Malaysia, Indonesia, Thailand etc.).
8. ***HUNGaMA*** *Survey Report on Poorest Child Development Indicators in 100 Focus Districts in Six States - Bihar, Jharkhand, Madhya Pradesh, Orissa, Rajasthan & UP* as reported in the ***Economic Survey 2011-12***, MoF, GoI, N. Delhi, p. 326, Box-13.6
9. ***Issues for Approach to the 12th Five Year Plan,*** Planning Commission, GoI, N. Delhi.
10. The 1st ***Gender Budgeting Statement*** was published by the MoF, GoI, for the Year 2005-06 side by side the *Union Budget 2006-07*.
11. Economic Survey 2012-13, op. cit., pp.291-292
12. **Economic Survey 2012-13,** op. cit., pp.291-94.

MODEL ANSWERS* TO SELECTED QUESTIONS

Reading maketh a full man; conference a ready man;
*and writing an exact man.***

* The answers given to some of the questions may be comprehensive. Readers are suggested to cut it short as per the requirement of the question. Questions in the civil services exam are generally asked in parts i.e. budgetary measures, monetary measures, administretive measures etc.

** Francis Bacon (1561-1626), 'Of Studies' **Essays**, London, UK, 1625.

Q. 1. Discuss the challenges faced by the public sector banks in the light of the emerging business opportunities in the banking sector.

Ans. Once India started banking sector reforms in the early 1990s, the banking industry saw multidimensional growth where new private banks were given licences, foreign banks allowed entry, universal banking became possible, etc. The hitherto closed banking sector with almost complete state monopoly (via the public sector banks–PSBs) was faced with multiple challenges. Private sector banks started entering the sector with state-of-the-art technology, making it more difficult for the PSBs to complete. Another challenging task for PSBs in the near future will be related to their human resource management. The market in the financial sector and especially in banking, is seeing growth driven by new products and services that include opportunities in:

(i) credit cards, consumer finance, and wealth management on the *retail side,* and

(ii) fee-based income and investment banking on the *wholesale side*. These require new skills in sales and marketing, credit and operations. Furthermore, given the demographic shifts resulting from changes in age profile and household income, consumers will increasingly demand enhanced institutional capabilities and levels of service from banks. The PSBs need to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management, and overall organisational performance.

The following steps (suggested by the RBI and experts) may help PSBs in handling these challenges:

(i) use of technology to reduce the gap created by shortage of staff and improving overall manpower efficiency.

(ii) a pool of talent for occupying leadership positions may be built up by banks by training and preparing promising officers to assume future leadership roles.

The challenges are going to be even tougher as the RBI has recently announced releasing some fresh licences for setting up new banks in the country.

Q. 2 Write a note on the need and the current government policy regarding disinvestment of the PSUs.

Ans. As many of the reserved sectors of industries were opened for private investment in the reforms era, the PSUs were thrown into a very tough competition posed by the Indian and foreign private investors who are equipped not only with the state-of-the-art technology but cutting edge management and marketing skills. To keep the PSUs in profitable condition and save their assets, they require heavy investment which the government lacks. Thus, disinvestment was opted for strengthing our PSUs.

The issue of disinvestment has been in debate since it was started. But recently it created news when the present Government (the UPA) did show a shift in its policy. By the end of 1999, the last Government had announced that the government holding in the ‘non-strategic’ industries would be cut down to 26 per cent—it meant that other than arms & ammunition; atomic power; mining R&D, fabrication, etc. of heavy metals; and the railways, all PSUs will become private industries.

Though the present government has not announced anything very clearly on this issue, it has said that as a policy, profit-making PSUs would not be disinvested.

What will be the degree of disinvestment? Experts believe that the ‘strategic’ sale of the PSUs would not be followed as the government is trying to go for reforms with a ‘human face’.

Meanwhile, the government looks committed towards the PSUs in many ways—how to make them more profitable, protecting the interest of the labourers in the process of reviewing the MoUs signed by the PSUs, etc. Protecting economic interests of the economy also includes the protection of social and human interests.

Q. 3 Cite the reasons for the state of under-developed corporate bond markets in India and suggest measures for its development.

Ans. Measures taken towards different segments of the finncial sector reforms since early 1990s have given visible results – in terms of market features and depth the Indian equity market today ranks among the best in the world; the government securities market has also evolved over the years and expanded. In contrast, the corporate bond market has not shown such a synergy and has remained a laggard - both in terms of market participation and structure. Emerging economies like Mexico, Russia, Poland, Brazil and Indonesia have more vibrant corporate bond markets in comparision to India.

Experts, together with the *Economic Survey 2010-11,* have cited several reasons for the under-development of the corporate bond market in India:

(i) Banks loans being the popular and predominant mode of raising long-term capital;

(ii) Participation of the FIIs is limited ;

(iii) Due of lack of investor confidence, pensions and insurance companies as well as household are limited participants; and

(iv) Crowding out of fund/investible capital by Government bonds.

Non-bank finance companies are the main issuers and very small amounts of finance are raised by companies/corporates directly.The corporate bond market as a result, is only about 14 per cent of the total bond market, while on the other hand, liquidity in the market and investment in the infrastructure sector remain constrained. With the intervention of the *Patil Committee* recommendations, the corporate bond market is slowly evolving. With bank finance drying up for long-term infrastructure projects in view of asset liability problems (faced by banking system), further development of a deep and vibrant corporate bond market is need of the hour (also suggested by the *World Bank*, recently).

Following steps may be taken for the promotion and development of corporate bond market in India:

(i) Clearing/settlement on DvP (Delivery versus Payment) basis; market making with primary dealers; enabling Credit Default Swap; guaranteeing of corporate bonds by banks; and relaxing norms on short selling of Government bonds (all fall under RBI’s preview).

(ii) Relaxing norms for use of shelf prospectus (requires amendment to Section 60 of Companies Act by the MCA).

(iii) Putting corporate bonds under SARFAESI (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest) Act (so that recovery becomes full- proof and investor’s confidence comes in).

(iv) Arrangement for a comprehensive bond data base.

(v) Lowering the stamp duties on the bond and making them uniform across states (Stamp Act needs to be amended by the Department of Revenue).

Q. 4 'Finance Commission (FC) and Planning Commission (PC) should work together for better development.' Elucidate.

Ans. The Constitution provides for a finance Commission to promote fiscal federalism and ensure decentralised ways of development. But Parliament gave it only the power to suggest the distribution of the Union's tax revenue. Meanwhile, the extra-constitutional body, Planning Commission started playing a more proactive role in the area of developmental issues and allocation of funds. It was the fourth Finance Commission (headed by P. V. Rajamannar) which, for the first time, suggested a cooperative approach between PC and FC. In the last few years, academicians and the experts have been suggesting the same thing.

It was in 2002 that the government, for the first time, announced such an idea (The then finance minister Mr. Jaswant Singh suggested this while announcing the setting up of the 12^{th} FC)—*the PC will be playing more or less a role of callaborator to the FC.* Mr. Som Pal was made a common member to both the bodies (after the UPA came to power, he resigned from the FC).

Experts appreciated the above governmental step as in the process of development; the FC has been left on the margins of the development process and the PC was playing a more important role. It is better they work in tandem since both are committed to economic development. The recent view of decentralised planning, coalition government, and requirement of greater fiscal federalism together demand a collaborative approach between these two bodies. By doing so, there is no doubt that a greater developmental purpose will be served.

Q. 5 Briefly describe the National Mission for Sustainable Agriculture.

Ans. Climate change has enormous implications for the natural resources and livelihood of the people. Various studies indicate that the key sectors in India such as the agriculture, water, natural ecosystem, biodiversity, and health are vulnerable to climate change. This is happening precisely at a time when it is confronted with huge development imperatives. The Indian Network for Climate Change Assessment (INCCA) released a report in November 2010 on assessment of the impact of climate change on key sectors and regions of India in the 2030s – agriculture being one among the four key sectors. The report warns of impacts such as sea-level rise, increase in cyclonic intensity, *reduced crop yield in rainfed crops, stress on livestock, reduction in milk productivity, increased flooding,* and spread of malaria. This called for urgency of action in reducing vulnerability to adverse impacts of climate change. India announced a National Action Plan on Climate Change (NAPCC) in June, 2008 to realise it, which includes 8 National Missions.

The National Mission for Sustainable Agriculture (NMSA) is among the 8 national missions which seeks to address issues regarding 'sustainable agriculture' in the context of risks associated with climate change. Major functions of the Mission have been defined as given below:

(i) devising appropriate adaptation and mitigation strategies for ensuring food security,

(ii) enhancing livelihood opportunities, and contributing to economic stability,

(iii) mainstreaming the adaptation and mitigation measures in R & D activities,
(iv) absorption of improved technology and best practices,
(v) creation of physical and financial infrastructure and institutional framework,
(vi) facilitating access to information and promoting capacity building,
(vii) promoting dryland agriculture by developing drought- and pest-resistant crop varieties,
(viii) expanding its coverage to rainfed areas for integrating farming systems with livestock and fisheries.

Under the aegis of the Central government, state governments are also preparing their State Action Plans aimed at creating institutional and programme-oriented capacities to address climate change. These, together with the National Missions, will enhance climate change-related actions in the public and private domains.

Q. 6 Write a note on the recent steps taken by the Government in the direction of fiscal consolidation.

Ans. After the IMF cautioned about the economy's fiscal parameters and the condition put by it concerning immediate fiscal consolidation, the Union government in mid-90s looked concerned about the matter. After a longer time of deliberations, ultimately an Act was passed by the Parliament in 2003—the Fiscal Responsibility and Budget Management (FRBM) Act—All political parties voted in favour of this Act. This should be considered the most important legislation in India in the direction of fiscal consolidation which envisages:

(i) Revenue deficit to be cut by 0.5 per cent of GDP per year.
(ii) Fiscal deficit to be cut by 0.3 per cent of GDP per year.
(iii) Fiscal deficit must be brought down to less than 3 per cent of GDP by 2007–08 and revenue deficit to zero by that time (UPA Government did it in 2008–09).

Further, the government did set stiffer targets; the revenue deficit down from 3.6 per cent to 2.5 per cent of GDP by March 2005. Other than FRBM Act, the government is also committed on the following fronts:

- Increasing *tax revenue*—imposing new taxes (service tax, transaction tax, etc.) besides broadening the tax base (income tax) as well as trying for better tax compliance and evasionless tax regime.
- Cutting down *revenue expenditure*—controlling interest burden by lesser borrowings, rationalising subsidies, right-sizing the government, etc.
- Encouraging states to adopt a uniform VAT so that the state government's revenue could be increased and cascading effect of tax could be restricted.
- Saving state governments from bankruptcy by proposing for them a share in the service tax and the custom duties.

A committee (task force) headed by Mr. Kelkar handed over its report to the government concerning the feasibility of the FRBM Act. Meanwhile, some populist tendencies have been seen among the states as many have gone for promising free electicity to the farmers; such sops are surely detrimental to the attempts of fiscal consolidation, as states are the real culprit in fiscal deficit at present.

Q. 7 What are tax-havens and how are they promoting corruption in India?

Ans. 'Tax havens' are nation-states or dominions imposing low or no taxes on personal and corporate incomes, and as a consequence tend to attract wealthy individuals and corporates seeking to minimize their tax liabilities. Other than saving taxes these havens are also used as a safe hub for parking **'black money'** created in different countries. As per the data of the OECD, there are at present over 70 such destinations in the world – popular ones are British Virgin Islands, Cayman Islands, Cook Islands, Dubai, Isle of Maw, Liechtenstein, Marshall Islands, St. Kitts and Nevis, Switzerland, Marritius, US Virgin Islands, etc.

The tax havens are promoting corruption in India in so many ways:

(i) They have emerged safe hubs for parking money earned in India.

(ii) As there are such parking centres, the black money individuals and corporates make in India, are easily hidden with no risk of getting caught.

(iii) Many Indian corporates have their operations in such places which they use for transfer pricing.

(iv) The parked funds get back to India in the form of 'hedge funds' destabilising the economy.

(v) As corruption is supposed to be very high in India, even politicians are believed to park their black money.

(vi) They accelerate hawala, bribery, etc. in India.

Recently, we have seen some effective actions being taken by the victim nations to unearth their funds parked in these havens such as the USA, Germany and many of the OECD nations. The Government of India has also started such initiatives recently.

Q. 8 Write a note on the changing dimensions of planning in India.

Ans. In the past one and half decades, we have seen great changes taking place in the process of planning in India. We may analyse the changes according to the below broad classifications:

(i) *Phase-I (1991–2002):* As India moved towards the era of economic reforms, the major change the government announced was the greater participation of the private sector in the developmental process and the nature of planning tilted more towards *indicative* planning — every new year has been a movement in this direction.

(ii) *Phase-II (Post 2002):* As the Tenth Five-Year Plan (2002–07) commenced, we saw many important changes taking place in the nature of planning — major ones are as given below:

   (a) *A serious mention* of the role of states in the process of planning — a complete departure from the past. Statewise growth targets worked in consultation with states, are clear pointers. "Unless states achieve their targets, nation can't achieve its target", says the plan. Planning heading towards real kind of *decentralisation* (73rd & 74th constitutional Amendments were forcing it also).

   (b) *Governance* has been recognised as a factor of development – the Plan suggests serious attempts in this direction.

   (c) The Plan is now implemented with special reference to economic reforms with the help of steering Committee.

(d) Planning Commission now monitors the progress of various central ministries.

(e) Agriculture sector declared as the *prime moving force* of the economy; governmental investment and attention tilting towards this sector after almost fifty years of the industry's dominance (as Amartya Sen suggested India to do).

(f) The changes in the view of planning are so pronounced that the Government has declared the plan as a *'reform plan'*. This Plan really intends to reform the way we planned.

Q. 9 'Economic reforms with human face'—examine the rationale behind it and the possible outcomes.

Ans. The new Union government (UPA) announced its committment to economic reforms with this sentence and the proverb got media attention. The political elite looks convinced today that the process of economic reform has not been able to take care of the masses, thus the future of the process will focus on it.

Economic reform with a human face is no empty rhetoric as it is based on stark realities and sound logic. As we know, in the era of reforms, the economy is moving towards the market economy in which demand/supply and price mechanism plays the main role. As a vast section of the population lacks the desired level of purchasing power, the process looks 'anti-poor' and thus, 'pro-rich'. Such reform processes might bring higher economic growth, but for equitable development, a conscious attempt for *inclusive growth* is essential.

The masses who lack the real level of purchasing capacity, should be supplied with subsidised goods and services till micro-level growth takes place. This is why the government is emphasising the *social sector* and enhancing its expenditure on the delivery of the so-called 'public goods' (education, water, healthcare, shelter, etc.).

However, analysts have cautioned the government that such policies are going to hamper growth and to increase fiscal deficit which will ultimately hurt development. But, till the poor are capable of taking on the market forces, the economy has to bear some cost. To sum up, we need growth for all—development and growth must be distributive; the Directive Principles of State Policy in our Constitution envisions the same idea.

Q. 10 Write a note on the present situation regarding current and capital account convertibility of rupee.

Ans. In the Union Budget 1992–93, the Liberalised Exchange Rate Mechanism Scheme (LERMS) was announced. Since then India has always been moving ahead in the direction of greater rupee convertibility, which may be seen as given below:

- In August 1994, rupee became **fully convertible** in the current account.
- In August 1994, the rupee became **partially convertible** in the capital account (60:40).
- The current policy regarding the capital account convertibility in India stands as given below:
  - (i) Rupee got full convertibility on Indian corporate's proposal of foreign investment upto \$ 500 million—put in automatic route approval.
  - (ii) Rupee became fully convertible in case of corporates intending to prepay their external

commercial borrowings (ECBs) above \$ 500 million—automatic route.

(iii) In August 2007, the Government allowed individuals to invest abroad with an upper limit of \$ 20,000 per year.

As India is becoming self-dependent in earning foreign exchange, we may hope that in the near future, government might be announcing rupee's full convertibility in the capital account. India's cautious moves towards full capital account convertibility has been appreciated by the IMF.

Q. 11 What is the term 'balance of payment'? Write a note on recent policies regarding BoP management in India.

Ans. Balance of Payment or BoP is the overall *statement* of a country's economic transactions with the rest of the world over a period, generally a year. The statement shows receivings from the world and the payments to the world basically shown in the current and the capital accounts. This statement is based on the principles of *accounting* – similar to the *balance sheet* of a company. It might turn out to be positive or negative. If it is negative and the economy is incapable to pay it, this is known as a BoP crisis. In such situations, the IMF remains as the last source of rescue.

- India had to rely on emergency operations from abroad to cope up with periodic BoP crises in 1973, 1979, 1981, and 1991. But after the economic reform process started, the situation started to improve.

As India started 'opening up' after 1991, as the part of the external sector reforms, its BoP has become *favourable* with each succeeding year. *Major policies* in this direction could be summed up as given below:

(i) Steps in the direction of opening the economy for healthy levels of foreign investments (FIs)—FDI as well as the (FIIs).

(ii) Optimum levels of convertibility to rupee in the current and the capital accounts.

(iii) Accelerated disinvestment of the prospective PSUs—including 'strategic sale' to the foreign bidders, too.

(iv) Follow up of LERMS (Liberalised Exchange Rate Mechanism System) in 1992–93.

(v) Modifications in the FERA – FEMA

(vi) Prudential management of the financial market with inputs of the required kind of reforms–money market, banking, insurance, stock markets, etc.

(vii) Required kind of trade policy, etc.

Q. 12 Write a note on the role played by the stock market in the development of the economy in India.

Ans. Aspirations of higher development could only be possible once higher growth rate is maintained. For higher growth rate, we need higher investment. As India had opted industry as its 'prime moving force' of the economy, the fund was managed by 'project financing' institutions. When banks managed to make their presence felt, they also started providing the investible funds. But the most attractive investible fund i.e. fund made available by the stock market, was not playing any

supportive role, as this was not organised. With the help of the conscious efforts made by the successive governments since 1992, Indian stock market has been able to make its presence felt around the world.

The Indian stock market is one of the fastest growing stock market in Asia. Its representative share index has crossed 20,000 mark (Sensex). The booming stock market is helping the economy in many ways:

(i) India is becoming less dependent on institutional project financing for investible funds.

(ii) Stock market is not only able to manage investible funds, but is increasing our forex receipts also. The government is trying to make it more lucrative by further liberalisation in the Portfolio Investment Scheme (PIS).

(iii) People's participation in growth and development is increasing day by day.

(iv) Stock market has emerged as the new route to manage investible funds.

This is how stock market has emerged as the most attractive route to manage investible funds and sustained growth rate. Naturally it has emerged as the 'new *mantra*' of growth and development.

Q. 13 Write a note on the logic behind increasing government emphasis on the social sector.

Ans. India's expenditure on the social sector has been rather poor (at 1.5 per cent of GDP) upto 1991, in comparison to the South East Asian economies (15 per cent of GDP since mid-1960s). This was basically responsible for the wretched state of education, healthcare, nutrition, drinking water, etc. Once India started economic reforms, the attitude towards its social sector expenditure went for a re-orientation.

As government's role in economy started shrinking and the nature of planning started shifting more in favour of the 'indicative' kind—emergence of the market economy—the people having lower purchasing capacity were badly hit. In this milieu, the government since then, has shown serious resolve regarding strong social sector and increasing emphasis on this sector, specially education and health.

The idea of common minimum programme had a direct bearing on the social sector and ultimately got a new target-oriented meaning in the current government's (National Common Minimum Programme). At present the government is giving top priority and increased emphasis to this sector in the following manner:

(i) Poverty alleviation (nutrition) got a new meaning in the NREGA.

(ii) Health is getting a hefty part of the government expenditure.

(iii) Drinking water programmes being run under the targets of the Planing Commission, which are easy to monitor.

(iv) Education (specially primary one) getting more emphasise.

(v) All programmes targeting quality improvement in the lives of the poor people are being synchronised and more focused now.

Q. 14 Write a short note on the new ideas, promoted by the Twelfth Finance

Commission in the area of fiscal management.

Ans. The President has been asking all Finance Commissions (FCs) to advise on the issue of deteriorating fiscal situation of the economy (Centre's as well states') since the Tenth FC. Though the Centre has tried to improve its fiscal situation via many tools since then, there has been almost no major step taken to do the same in the case of states—their situation had worsened throughout the 1990s. The recommendations of the 12th FC are considered as a watershed example in this regard, which could be considered as the new ideas pointing towards fiscal prudence among states:

(i) *Consolidation of the States loans:* The commission recommends that once the states pass their Fiscal Responsiblity Acts (FRAs) (on the lines of centre's FRBM Act) their loans raised upto March 31, 2004 would be converted into fresh loans for a further 20 years, that too on a cheaper interest rate of 7.5 per cent p.a. (This would cost the Centre Rs.30,000 crores).

(ii) *Incentive for cut in the revenue deficit:* The amount by which states cut their revenue deficit would be written off by the Centre from their borrowings.

(iii) *Freedom for market borrowings:* Once states start with FRAs, they would be allowed to manage a part of their planned expenditure via market borrowings. This is supposed to bring in fiscal prudence among the states.

States have started following the new ideas suggested by the FC and enacted by the Centre. In this way the historic FRBM Act is getting a new meaning in the economy. At the same time, the complaint of states that they are dependent on central funds is also on the wane.

Q. 15 Write a note on the benefits of the VAT to the Indian economy.

Ans. Value Added Tax (VAT) is an indirect tax to be collected at all those points where value is added to a product. It has the following positive impacts on the economy:

(i) Due to differentiation among states regarding the rates of the Sales Tax, India was having differentiated market prices, this tax will bring in 'uniformity' in the market.

(ii) Since this tax is imposed at different points of the value addition chain, it does not impose tax upon tax; that's why there won't be any 'cascading effect' of tax on inflation.

(iii) This will automatically check the evasion of the sales tax.

(iv) This is a pro-poor tax without being anti-rich.

(v) This will enhance production levels as prices go down and cousumption increases.

(vi) Supportive to the economic growth.

(vii) It will increase the tax revenue of the states.

(viii)It will become easier to attain fiscal responsibility for the economy.

Q. 16 Write a note on the prospects and challenges to Indian agriculture in the WTO regime.

Ans. As the provision of the WTO came into effect, experts rightly visualised great prospects and at the same time some serious challenges for the Indian agriculture sector. As far as the extent of the prospects are concerned, immense export potential is visible in the following areas:

(i) Cotton textile, yarn, readymade garments, etc.

(ii) Agricultural products, cereals, fishery products, and forest goods.

(iii) Processed foods, beverages, and soft drinks. A joint projection of the OECD and the GATT did put an increase in the world merchandise trade by $745 billion upto 2005 once the WTO provisions get implemented. As per the projection, 99 per cent of this trade almost falls in the agriculture sector. As India has been an agrarian economy and enough prospects for agricultural expansion are possible, it can encash this opportunity (NCAER survey supported this in 1993–94).

We may see the possible major challenges in the WTO regime:

(i) *Food self-sufficiency:* As cheaper food-grains will have unrestricted flow into India, we might become almost dependent upon import supplies for our food requirement–our self-reliance is badly threatened.

(ii) *Price-stability:* The price stability aspect of agricultural products, specially the sensitive foodgrains, will be in great risk as fluctuations in the imports are natural (agriculture being highly prone to weather and the climatic variations) hurting the poor people.

(iii) *Cropping pattern:* Cropping pattern of India might go in for a major shift in favour of the profitable crops threatening the fragile ecosystem and the balance of biodiversity.

All the above given challenges could be dealt with the suitable type of timely agricultural and trade policies—but WTO provision does not give such kind of sovereign choices to its member countries. It means we need to go for flexibility in the provisions of the WTO.

(iv) *Weaker Sections:* Weaker sections of the society will again miss the train of globalisation for their upliftment as the process of globalisation is not neutral to area, crop, and the individual. We will need a more focussed distributive kind of economic policies to do it.

(v) *Commitments towards the WTO:* Our agricultural subsidy cannot cross the 10 per cent mark of the agricultural GDP, any year. Though this is still not alarming, the higher subsidies forwarded by the USA and the EU is diluting the competitiveness of Indian agricultural goods —the 'Blue Box' and the 'Green Box' subsidies need redefinition immediately.

Conclusion: Visualising the emerging challenges to the agriculture sector of the developing countries, like-minded nations came together (G-22) and tried to go for a justified change in the provisions of the WTO—Seattle, Doha, Cancun, and Hong Kong. Agriculture was the most important issue because of which the important ministerial conference at Seattle failed. At the Hongkong conference in December 2005, an agreement on the withdrawal of agricultural subsidies by the Euro-American countries came as a help. The 7th WTO Ministerial meeting held in Geneva from November 30–December 3, 2009 provided for different groups and caucuses to access the direction of the negotiations.

Q. 17 'Hedge funds and black money in India's economy look intertwined'. Comment.

Ans. Hedge Funds are privately owned huge external funds with swift movement tendencies dedicated to minimise the financial risks of external investments. Every economy with high growth rate as well as a vibrant stock market is a possible destination for it. As per a recent IMF report, such

funds together amount to over $1500 billion. Attractive foreign investment policies of the countries are the main reasons for their inflows, provided there is liberal outflow policies too.

In the case of India, these funds have been blamed to generate black money, by the experts. The government has also taken steps to reign them. The main instrument via which these funds look intertwined with the generation of black money in India has been the 'participatory notes' (PNs) through which a FII may invest into India's share/stock market without disclosing the source of the funds to the SEBI. Similarly, Overseas Derivative Instruments (ODIs) are other routes frequently used by the 'Hedge funds' to channelise black money into India, which are kept overseas in major tax-havens. Finally, these funds are not only giving Indian black money a legal re-entry, but also a route to finally exit India.

Q. 18 Write a note on the role of the states in the ongoing process of economic reforms.

Ans. Economic reforms started in 1991–92, but the benefits to the states and the masses looks unbalanced.

Reasons and Solutions

- Due to the special federal structure of India, economic reforms though well-started by the Union, could not be complemented by the states.
- A certain degree of working and effective political and financial autonomy are desirable for the states so that they may move towards reaping the fruits of the reform process.
- Lack of political coordination as well as cooperation between the goverments at the Centre and the states.
- Process of reform should have been initiated by the states and facilitated/supported by the Centre (Union Budget 2002–03 already announced it for future reform).
- The design and centralising nature of the Planning Commission need a change in favour of greater participation from the states so that the deteriorating regional disparities in the reform period (over one and half decades) could be checked (such a change was initiated with the tenth Plan).
- Panchayati Raj Institutions (PRIs) should be given effective powers by the states so that the benefits could reach the masses via mass participation.
- Streamlining of the rules and regulations from the Centre to the states.
- Better governance, check on the menace of corruption, legal reforms, infrastructure support, etc.
- The Twelfth Finance Commission has provided the states greater financial leverage by allowing market borrowings for their plan development.
- The implementation of the VAT has opened better prospects for tax collections by the states—to be boosted once the GST (goods and services tax) gets implemented.
- The Eleventh Plan has made it compulsory for the states to make their PRIs a working entity for fund devolution for the development of local areas.
- Providing gainful employment to the labour force over the plan period.

Q. 19 Write a note on the situation and importance of the Private Remittances for India.

Ans. As per the report of UNDP, by end-2010, Indians were the second biggest diaspora, estimated at 25 million and among the largest 'sending' nations in Asia. Not only now, the 'private remittances' (PRs) of India was of crucial importance in the former decades after the Independence. Since then, it has gone swelling every year, with a major jolt to it in the early 1990s due to the Gulf war. As the Gulf became less attractive, the rise of the IT industries saw a major acceleration in PRs with Indian expatriates joining this emerging labour force is a big way.

As per the laterst data provided by the IMF/WB in 2013, India received the highest PRs in the world totalling to \$57 billion (China being 2nd at \$53). Its importance for India could be seen as given below:

(i) The value of the PRs today stands at one sixth of its total foreign exchange reserves.

(ii) India is able to promote and Sustain its huge current account deficit (2.5 per cent of GDP, now) with comfort.

(iii) Indian diaspora not only plays a vital monetary role for India, but they gave a relative edge to Indian diplomacy too.

(iv) They play a major role in India's emerging economic diplomacy. Looking at their importance, the GoI in recent years has become more concerned about the welfare of its diaspora.

Q. 20 Discuss the challenges related to providing universal healthcare in India.

Ans. Health indicators of India have been always low due to many resons and they still remain a matter of great concern for the GoI and UN bodies. Despite higher economic growth, India fares poorly when compared to countries like China and Sri Lanka in term of parameters like per capita expenditure on health, number of physician/hospital beds and IMR. In addition, within the country, the improvement has been quite uneven across regions/states, gender, rural/urban areas, etc. The health system in India is a mix of the public and private sectors, with the NGO sector playing a small role. In providing universal healthcare, the country faces the following challenges:

Physical challenges are related to having adequate number of trained personnel, hospitals and other infrastructure. The centre and state need active participation from the private sector and the NGOs.

Economic challenges are related to the mobilisation of funds to meet the physical challenges at one hand, while on the other, delivering the required medical services to the needy people.

Universal health insurance is under consideration with government supported premium payment.

Government plans to promote the private sector and NGOs in its preperation for putting the right kind of physical set up while the delivery is to be taken care via the UID based insurance smart cards. Planning Commission has targeted to increase health expenditure to 2-3 per cent of GDP in the 12th Plan (from 1 per cent of GDP of the 11th Plan). However, sceptics doubt the efficacy of the smart card-based healthcare delivery due to information divide in the country.

Q. 21 Examine India's food security in light of the record foodgrain production is 2010-11.

Ans. India has achieved a record foodgrain production of 241 million tonnes (MT) in the 2010-11 crop year with record production in wheat, maize and pulses. This has really encouraged the hope of attaining food security for the country. We may analyse it as given below:

(i) India's population growth rate at present is 1.76 per cent (as per the provisional data of census 2011) while its foodgrain growth rate is just at about 'one per ent per year (since 1996-97). It put a pressure of 0.76 per cent per year on production of the foodgrains.

(ii) As per the latest data released by the Governement of India, by 2020-21 the country will need a total of 281 MT of food grains for its consumptuion – it is only possible once we are able to achieve a 2 per cent annual growth rate in foodgrain production.

(iii) Once the Universal Right to food becomes effective, the real pressure on the physical availability of foodgrain will start showing up.

(iv) Scarcity of foodgrains has been a major reason for their price rise in the recent years, as with increasing income, there is increased demand of food grains from the newer population of the country.

In the process of attaininy food security the Government is going for a multi-dimensional approach:

(i) second green revolution with emphasis on plant protection, organic farming, new seeds, use of bio-tech, etc.

(ii) promoting contract and corporate farming.

(iii) Action and policies regarding the effects of climate change on agriculture.

(iv) Marketing and distribution reform.

(v) Targeting agricultural subsidies in a right way.

(vi) Promoting agricultural research through private-public participation.

(vii) Trying to make farming a remunerative profession.

Q. 22 Write a note on the strategy of monitorable development targets initiated by the Eleventh Five-Year Plan.

Ans. The 11th Plan (2007–12) has identified 27 targets at the national-level related to income and poverty, education, health, women and children infrastructure and environment, whereby 13 of the 27 targets, which are easy to monitor, have been set for the states (after due consultations with them). The strategy of setting such development targets is supposed to serve the following purposes to the economy:

(i) It will prevent the Plan faltering from its desired goals and help the Centre to achieve the objectives contained in the National Common Minimum Programme (NCMP);

(ii) It will not only give the Government a real time picture of development, but allow enough time to intervene without waiting for the plan completion;

(iii) The move would also address the issue of regional and sub-regional inequalities;

(iv) It will increase governmental efficiency in going for more 'inclusive growth';

(v) The idea will promote the cause of 'performance budgeting' in a more timely and transparent way;

(vi) It will increase the element of 'governance' among the states as their performance on the 13 easy-to-monitor targets will be key to timely release of Centre's budgetary allocations to them (the Centre and the Planning Commission have been highly critical about the issue of governance at the state level). As the states control the main services (i.e., health, education, drinking water, nutrition, etc.) on which people's standard of living depends directly, it has become essential to make the states more equipped and accountable regarding delivery of these services.

Q. 23 'Leakages are the cause by which food subsidies fail to reach the target population adequately'. Comment.

Ans. As the country headed for the Green Revolution in 1965, a proper method of food distribution also began with the commencement of the Public Distribution System (PDS). The PDS will become the main route to pass food subsidies to the needful population due to the lower level purchasing capacity of a big section of India. The expenditure on the heads of food subsidies went on increasing even after restructuring of the this PDS. There was a general criticism that these subsidies leak and do not reach the target population. In recent years, several measures were taken to stop the subsidies from going outside the target population, but things do not seem improving. The situation of leakage in the food subsidies through PDS may be seen via two studies, released recently–

(i) In 2001-02, 18.2 per cent of PDS rice and 67 per cent of wheat was diversted from the ration shops to the open market – it means over 40 per cent of all foodgrains with subsidies missed the poor masses (Reetika Khera, 211, as cited in the Eco. Survey 2010-11).

(ii) In 2004-05, there was an overall diversion of 55 per cent of the grain meant for the poor (Sikha Jha & Bharat Ramaswami, 2010, as cited by Economy Survey 2010-11).

No matter where the exact figure of leakage lies between 40-55 per cent, once legal rights to food is given using the PDS delivery system, it will double the offtake and food subsidies – increasing expenditure hugely, with no guarantee of a fool proof delivery! This is why the Unique Identification Number (Aadhar) is proposed to be used by the government so that the food subsidies are not diverted and become leakage-proof. The cash delivery will deburden the country of leakage of subsidies.

Q. 24 Write a short note on India's policy steps regarding harnessing the 'demographic dividend'.

Ans. There has been a marked decline in the dependency ratio (ratio of dependent to working age population) in India. The ratio fell down from 0.8 in 1991 to 0.73 in 2001 and is expected to further decline sharply to 0.59 by 2014. This decline sharply contrasts with the demographic trend in the industrialised countries and also in China, where the ratio is rising. It is projected that the proportion of population in the working age group (i.e., 15–64 years) in India will increase from 62.9 per cent (2006) to 68.4 per cent in 2026.

Low dependency ratio and a high proportion of the working population gives India a comparative cost advantage, and a progressively lower dependency ratio will result in improving India's competitiveness in the global economy. The Government of India seems fully aware of this advantage

and that is why the Eleventh Plan (2007–12) is implementing a ***three-pronged strategy*** to tap demographic dividend:

(i) Ensuring proper healthcare to all,

(ii) Emphasis on skill development (knowledge industry), and

(iii) Encouragement of labour intensive industries.

The Eleventh Plan document also suggests a word of caution—'if we get our skill development act right, we will be harnessing a demographic dividend, however, if we fail to create skills, we could be facing a demographic nightmare.'

Q. 25 Write a short note on the recently launched National Food Security Mission.

Ans. India's food secruity scenario has been a matter of concern for the important national and international agencies in the recent times—so has it been for the Government of India. The issue was discussed in a constructive way at the 53rd meeting of the National Development Council (NDC) early 2007. In pursuance of the resolution of the NDC, the Department of Agriculture & Cooperation, Ministry of Agriculture launched a Centrally - sponsored scheme on National Food Security Mission (NFSM) starting with the Eleventh Plan. The ***objective*** of the Mission is to increase the production of rice, wheat and pulses by 10, 8 and 2 million tonnes, respectively, over the benchmark levels of production, by the end of the Eleventh Plan. The Mission *aims* to do the same through the following ***measures:***

(i) Area expansion and productivity enhancement;

(ii) Restoring soil fertility and productivity;

(iii) Creating employment opportunities, and

(iv) Enhancing farm level economy to restore confidence of farmers of targeted districts.

The implementation of the NFSM relates to *various activities* pointed by the Government as given below:

(i) Demonstration of improved production technology;

(ii) Distribution of quality seeds of high yielding varieties (HYVs) and hybrids;

(iii) Popularisation of newly released varieties, support for micro-nutrients; and

(iv) Training and mass media compaign including awards for best performing districts.

The Mission gives flexibility to the identified districts to adopt any local area specific interventions as are included in the Strategic Research and Extension Plan (SREP) prepared for the agriculture development of the district. During the Eleventh Plan period, the total outlay of NFSM is Rs. 4,882.5 crore.

Q. 26 Write a concise note on the recently launched Rashtriya Krishi Vikas Yojana.

Ans. There has been a declining trend in the governments' share of investment in the agriculture sector for the past few decades due to various reasons. The issue has been a matter of great concern

for the governments in recent times. It was highly contemporary that the National Development Council (NDC) in its 53rd meeting (early 2007) decided to launch a programme to incentivise the states to increase the share of investment in agriculture in their state plans. Accordingly, on August 16, 2007 the Government approved the *Rashtriya Krishi Vikas Yojana* (RKVY) with an allocation of Rs. 5,000 crore for the Eleventh Plan period.

The RKVY *aims* at achieving the 4 per cent annual growth rate in the agriculture sector during the Eleventh Plan by ensuring a holistic development of agriculture and allied sectors.

This is a State Plan Scheme and the eligibility for assistance under the scheme would depend upon the amount provided in the State Budgets for agriculture and allied sectors, over and above the baseline —percentage expenditure incurred on the sectors. The funds under the scheme would be provided to the states as *100 per cent grant* by the Central government. The main objectives of the scheme are as given below:

(i) Incentivising the states to increase public investment in the agriculture and allied sectors;

(ii) Providing flexibility and autonomy to the states in planning and executing schemes for the sectors;

(iii) Ensuring the preparation of plans for the districts and the states based on agro-climatic conditions, availability of technology and natural resources;

(iv) Ensuring that the local needs, crops and priorities are better reflected in the states plans;

(v) Achieving the goal of reducing the yield gaps in important crops, through focused interventions; and

(vi) Maximising returns to the farmers.

Q. 27 Write a short note on the relationship between stock market and the economy.

Ans. After the Government of India started initiatives in the direction of an organised stock market by late 1980s, too much water has flown since then in this sector. Indian stock market has been making waves throughout the last decade. Today, it is in the headlines due to two paradoxical reasons. Firstly, the pessimism ensuing from the subdued performance of the major stock indices for the last many weeks and secondly, the international opinions and surveys putting Indian stock market among the fastest growing markets of the world. It is right time to analyse the relationship of the stock market to the economy at large. Though experts lack a complete consensus on the issue, we may point out the broader contours of the relationship in the following way:

(i) The equity prices can affect the household income. By their rise, households feel richer as the value of their equity holdings rises, and this 'wealth effect' then spills over into higher consumption ultimately boosting both demand and investment in the economy. The opposite can induce slowdown and even recession as well as sluggish investment.

(ii) Equity prices have a direct impact on the business confidence in an economy.

(iii) A strong and vibrant stock market increases borrowing capacity by raising the value of assets to put as collateral into the banks and the financial institutions.

(iv) Equity price rises raise the market capitalisation of a listed company relative to the

replacement cost of its current assets (a factor known as ***Tobin's q***) which induces entrepreneurs to add capacity.

There are many real life examples from around the world which validate the point that a vibrant and rising stock index has been resulting into higher growth rates for the concerned economies between 1951–2005.

Q. 28 Write the main reason of price rise in recent times and discuss the steps taken by the GoI & the RBI to check it.

Ans.[1] Rising prices continued to remain in news throughout the financial year 2012-13. Price rise was basically led by the food products, chiefly the common protein-suppliers like milk, milk products, meat, egg and fishes. To contain the price rise the steps taken by the GoI/RBI were as given below (as per the latest *Economic Survey 2012-13,* p. 93) –

(i) *Fiscal Measures*

(a) Import duties for wheat, onions, pulses, and crude palmolein were reduced to zero and 7.5 per cent for refined vegetable & hydrogenated oils.

(b) Duty-free import of white/raw sugar was extended up to 30 June 2012; presently the import duty has been fixed at 10 per cent.

(ii) *Administrative Measures*

(a) Ban on exports of onions was imposed for short periods of time whenever required. Exports of onions were calibrated through the mechanism of minimum export prices (MEP).

(b) Futures trading in rice, *urad, tur,* guar gum and guar seed was suspended.

(c) Exports of edible oils (except coconut oil and forest-based oil) and edible oils in blended consumer packs up to 5 kg with a capacity of 20,000 tons per annum and pulses (except *Kabuli chana* and organic pulses and lentils up to a maximum of 10,000 tonnes per annum) were banned.

(d) Stock limits were imposed from time to time in the case of select essential commodities such as pulses, edible oil, and edible oilseeds and in respect of paddy and rice up to November 30, 2013.

(iii) *Measures to Insulate the Vulnerable Sections*

(a) The central issue prices (CIP) for rice (at Rs. 5.65 per kg for below poverty line [BPL] and Rs 3 per kg for Antodaya Anna Yojana [AAY] families) and wheat (at Rs 4.15 per kg for BPL and Rs 2 per kg for AAY families) have been maintained since 2002.

(b) Under the targeted PDS (TPDS) allocation of foodgrains is being made to 6.52 crore AAY and BPL families at 35 kg per family per month at a highly CIP.

(c) The government has allocated rice and wheat under the Open Market Sales Scheme (OMSS).

(d) The scheme for imports of pulses which envisaged imports for distribution to BPL households through the PDS with a subsidy of Rs 10 per kg operated from November 2008 to June 2012. The government has decided to implement a varied form with a subsidy element of Rs. 20 per kg per month for BPL cardholders for the residual part of the current year. The targeted BPL cardholders will be as estimated by the Department of Food and Public Distribution.

(e) The Scheme for Distribution of Subsidised Imported Edible Oils has been implemented since 2008-09 through state/union territory (UT) governments for distribution of 1 litre per ration card per month with a central subsidy of Rs. 15 per kg. The scheme has been extended up to 30 September 2013.

(iv) *Budgetary and other Measures*

(a) A number of measures were announced in Union Budget 2012-13 to augment supply and improve storage and warehousing facilities. The government launched a National Mission for Protein supplements in 2011-12 with an allocation of Rs. 300 crore. To broaden the scope of production of fish to coastal aquaculture, apart from fresh water aquaculture, the outlay in 2012-13 was stepped up to Rs. 500 crore. Recently, the government permitted FDI in multibrand retail trading. This will help consumers and farmers as it will improve the selling and purchasing facilities.

(v) *Monetary Measures*

(a) The RBI had also taken suitable steps to contain inflation with 13 consecutive increases by 375 basis points (bps) in policy rates from March 2010 to October 2011.

Q. 29 Write a short note on the sub-prime crisis and point out the lessons for India.

Ans. The sub-prime crisis is related to the US mortgage market which first surfaced in July 2007. Simply said, this is a financial crisis generating from the default of the borrowers. It means that it is like the non-performing assets (NPAs) crisis of banks in India. But the analyses of the situation and the mode of financing involved make it highly complex. Let us have a look on the whole matter in the following steps:

Step 1: Borrowers with poor or less than standard (that is why *'sub-prime')* credit records were encouraged (to borrow by some of the world's leading banks and financial institutions!).

Step 2: These 'sub-prime loans' were then sold to other investment banks by the original lending banks and institutions.

Step 3: The investment banks (who purchased the sub-prime loans from the original lenders) in turn converted them (the loan papers) into marketable, complex financial instruments to spread risks and manage liquidity (i.e., fund).

Step 4: When the sub-prime borrowers defaulted in their repayment of mortgaged loans, the financial crisis originated–today known as the 'sub-prime crisis' around the world.

As the banks and financial institutions of the world are today more inter-connected due to financial globalisation, the crisis has spread to other non-US economies. The seriousness of the matter is best illustrated by the fact that no one knows who owns the bad debts. Worse, banks do not seem to know the extent of risks in some of the instruments they have created or for that matter when and where to expect them. The credit rating agencies involved with the debt instruments are themselves badly confused. The US government proposed a radical financial reform programme in late March, 2008.

Basically, in the name of financial innovation and cut-throat competition in the financial world, there is always a risk that banks start adopting/promoting highly risky, complex and questionable financial practices. Two long-term measures will help to prevent such crises to occur again:

(i) The financial instruments should be made transparent enough and easily communicated to the buyers, and
(ii) The buyers should have at least basic knowledge of how these instruments work and the risk involved.

India must take lessons from the crisis and every liberal financial move should be guarded with utmost transparency.

Q. 30 Write a descriptive note on the emerging challenge of inflation targeting in India.

Ans. A stable rate of inflation is among the most important things for the growth of an economy–both from domestic and external point of view. It was in mid-1970s that the RBI was given the function to stabilise inflation–and 'inflation targeting' commenced in India. A new term was born–'threshold rate of inflation' (considered 5 per cent)–in late 1990s to connote the level beyond which prices hurt all sectors of the economy. Now, once the economy has started globalisation vigorously, the challenge of stabilising as well as targeting inflation has become more complex. The current challenge of inflation targeting in India may be seen in two perspectives:

(i) As Indian economy is more open now, it has become necessary to keep its inflation in tandem with global trends to ward off crises with exchange rate, banking, insurance, investment, etc. As most of the developed economies have inflation below 3 per cent, we have an immediate obligation to target this level (as we are competing with these economies in the globalised era).
(ii) At another level, the comfortable range of inflation for India is considered 4–5 per cent (almost 2 per cent higher to the obligation of globalisation). But an economy like India which has great growth potential but wretched human development, a lower level of inflation will hinder its growth (there is trade off between inflation and growth). As inflation crossed the 7 per cent level by the first week of April 2009, the government has taken many measures to cool it down. But in the long-run every attempt to cut it to 3 per cent level will hamper investment and growth.

Indian economy is today faced with the above-given twin and paradoxical challenges regarding inflation targeting.

Q. 31 Write a brief note on the role played by the Micro Management of Agriculture (MMA).

Ans. The MMA is a Centrally sponsored programme launched in 2000-01 aimed at complementing/supplementing the States' efforts towards enhancement of argicultural production and productivity. The Revised (2008-09) MMA has the following salient features:

(i) Funds are allocated on gross cropped area basis (unlike on historical basis of past).
(ii) Subsidy structure rationalised and made similar to the other schemes sponsored by the Centre.
(iii) Two new components have been added, namely – (a) Pulses and Oilseeds Crop Programmes (POCPs) for the areas not covered under the Integrated Scheme of Oilseeds, Pulses, Oil Palm

and Maize (ISOPOM) and (b) Reclamation of Acidic Soil (RAS) launched along with the existing component of Reclamation of Alkali Soil (RAS).

(iv) Ceiling for new initiatives increased to 20 per cent (from 10 per cent).

(v) 33 per cent of the funds earmarked for small, marginal and women farmers.

(vi) Active participation of the PRIs in review, monitoring and evaluation.

Funding pattern is in the ratio of 90:10 between Centre and states except the north-eastern states for whom the 100 per cent Central funding is extended as Grant.

Q. 32 What are the causes of recent rupee slide.

Ans. Rupee has been showing a serious tendency of depreciation since mid-September 2011 and presently it is at Rs 56, per dollar. The US dollar is at its eight months high today against its major rivals. The reasons for rupee slide and dollar high are driven by the following reasons:

(i) the rupee is sliding on account of strong demand from importers (oil is India's biggestimport and domestic oil firms are the largest purchasers of the dollar in the local currencymarket).

(ii) banks in India are also creating high demands for dollars.

(iii) the greenback is being seen as a *safe haven*, especially at a time when risk aversion issweeping through global financial markets. The weakening Euro is the chief concern for the world investors – making them search for a safe heaven.

(iv) though the downgrading of the US dollar is another concern – as the international investors are still showing hope in the dollar (due to weakening euro) it has not beentranslated into stronger rupee (as banks and importers are demanding more dollars).

(v) world stocks stumbled from the 1-1/2 month high on October 18, 2011 and government bonds rose as slower-than-expected Chinese growth and a warning on France's AAA sovereign credit rating prompted investors to cut risks.

The depreciating rupee has emerged as a major concern for policymakers/ RBI in India – which puts a threat of spiralling into further price rises. In the given situation, if the central bank intervenes to support the rupee, it will increase its supply into the economy again fueling inflation which has already been the biggest challenge for the government for the past one and half years.

Nevertheless, the decline in the rupee exchange rate has given merchandise and software exporters cause for *cheer*, as they will enjoy better profits from the more competitive export prices. Recently concluded quarter has seen a very high export growth rate in India.

The normalcy in the demand of dollar and cooling down of the rupee is intertwined with the financial health of the crisis-ridden European economies. A strong intervention by the major European economies has every chance of rejuvenating the economy and arresting the slide of the rupee.

Q. 33 Write a contemporary note on the importance and the role played by the WIPO.

Ans. The World Intellectual Property Organisation (WIPO) is a specialised agency of the United Nations. It is dedicated to developing a balanced and accessible international intellectual property (IP) system, which rewards creativity, stimulates innovation and contributes to economic

development while safeguarding the public interest. WIPO was established by the WIPO Convention in 1967 with a mandate from its Member States (today it is 184) to promote the protection of IP throughout the world through cooperation among states and in collaboration with other international organisations. Its headquarters are in Geneva, Switzerland and its present Director General is Francis Gurry.

Strategic Goals

WIPO's revised and expanded strategic goals are part of a comprehensive process of strategic realignment taking place within the Organisation. These new goals will enable WIPO to fulfill its mandate more effectively in response to a rapidly evolving external environment, and to the urgent challenges for intellectual property in the 21st Century. The nine Strategic Goals were adopted by Member States in 2008-09 which are:

(i) Balanced Evolution of the International Normative Framework for IP.

(ii) Provision of Premier Global IP Services.

(iii) Facilitating the Use of IP for Development.

(iv) Coordination and Development of Global IP Infrastructure.

(v) World Reference Source for IP Information and Analysis.

(vi) International Cooperation on Building Respect for IP.

(vii) Addressing IP in Relation to Global Policy Issues.

(viii) A Responsive Communications Interface between WIPO, its Member States and All Stakeholders.

(ix) An Efficient Administrative and Financial Support Structure to Enable WIPO to Deliver its Programs.

The Strategic Goals will provide the framework for WIPO's six year Medium Term Strategic Plan (2010-2015).

Q. 34 'India's foreign investment regime has become more liberalized in recent times'. Comment.

Ans. To promote the flow of foreign funds into the economy, the RBI on ***January 24, 2013***, further liberalised the provisions of investment in India's security market –

- *FIIs* and ***long-term investors*** [2] investment limit in Government Securities (G-Secs) enhanced by US $5 billion (to US $ 25 b).
- Investment limit in corporate bonds by the above-given entities enhanced by $5 billion (to $50 billion).
- The RBI also relaxed some investment rules by removing the maturity restrictions for first time foreign investors, on dated G-Secs. But such investments will not be allowed in short-term paper like Treasury Bills.
- Foreign investors restricted from investing in the 'money market' instruments – certificates of deposits (CDs) and commercial paper (CPs).

- In the total corporate debt limit of \$50 billion, a sub-limit of \$25 billion each for infrastructure and other than infrastructure sector bonds has been fixed.
- Rules requiring FIIs to hold infrastructure debt for at least one year has been abolished.
- The qualified foreign investors (QFIs) would continue to be eligible to invest in *corporate debt securities* (without any lock-in or residual maturity clause) and *mutual fund debt schemes*, subject to a total overall ceiling of \$1 billion (this limit of \$1 billion shall continue to be over and above the revised limit of \$50 billion for investment in corporate debt).
- As a measure of further relaxation, it has been decided to dispense with the condition of one year lock-in period for the limit of \$22 billion (comprising the limits of infrastructure bonds of \$12 billion and \$10 billion for non-resident investment in IDFs) within the overall limit of \$25 billion for foreign investment in infrastructure corporate bond.
- The residual maturity period (at the time of first purchase) requirement for the entire limit of \$22 billion for foreign investment in the infrastructure sector has been uniformly kept at 15 months. The five-year residual maturity requirement for investments by QFIs within the \$3 billion limit has been modified to three years original maturity.

Q. 35 What is Double Taxation? Write a current note on the situation of the Double Taxation policy followed by India.

Ans. Due to phenomenal growth in international trade and commerce and increasing interactivity among the nations, residents of one country extend their sphere of business operations to other countries. Cross-country flow of capital, services and technology is the order of the day particularly after our country embarked on the path of globalisation of economy. Presence of double or multiple taxation acts as a major determining factor in decisions relating to location of investment, technology etc. as it affects the bottom-line of a business enterprise. The effort is, therefore, to ensure that heavy tax burden is not cast as a result of double or multiple taxation. The object is achieved by the government entering into agreements with other countries whereby the respective jurisdiction is so identified that a particular income is taxed in one country only or, in case it is taxed in both the countries, suitable relief is provided in one country to mitigate the hardship caused by taxation in another jurisdiction.

The situation of double taxation occurs when an individual is required to pay **two** or **more** taxes for the ***same income***, ***asset,*** or ***financial transaction*** in different countries - mainly due to overlapping tax laws and regulations of the countries where an individual operates his business. When an Indian businessman makes a profit or some other type of taxable gain in another country, he may be in a situation where he will be required to pay a tax on that income in India, as well as in the country in which the income was generated. To protect Indian tax payers from this unfair practice, the Indian government has entered into tax treaties, known as **Double Taxation Avoidance Agreement** (DTAA) with 65 countries, including U.S.A, Canada, U.K, Japan, Germany, Australia, Singapore, U.A.E, and Switzerland. DTAA ensures that India's trade and services with other countries, as well as the movement of capital are not adversely affected. Such agreements are known as "Double Tax Avoidance Agreements" (DTAA) also termed as ***"Tax Treaties"*** (TTs). The statutory authority to enter into such agreements is vested in the Central Government by the provisions contained in *Section*

90 of the Income Tax Act.

The Income Tax relief against double taxation is provided in two ways:

(i) Unilateral Relief: Under *Section 91*, the Indian government can relieve an individual from double taxation irrespective of whether there is a DTAA between India and the other country concerned. Unilateral relief may be offered to a tax payer if:

   (i) The person or company has been a resident of India in the previous year.

   (ii) The same income must be accrued to and received by the tax payer outside India in the previous year.

   (iii) The income should have been taxed in India and in another country with which there is no tax treaty.

   (iv) The person or company has paid tax under the laws of the foreign country in question.

(ii) Bilateral Relief: Under *Section 90*, the Indian government offers protection against double taxation by entering into a DTAA with another country, based on mutually acceptable terms. Such relief may be offered under two methods:

   (a) ***Exemption method:*** This ensures complete avoidance of tax overlapping.

   (b) ***Tax credit method:*** This provides relief by giving the tax payer a deduction from the tax payable in India.

Apart from providing ways and means to avoid double taxation of same income, the agreements generally provide for other matters of common interest of the two countries ***such as***: exchange of information; mutual assistance procedure for resolution of disputes; and for mutual assistance in effecting recovery of taxes. Treaties being international agreements, their consequences are determined according to the rules of ***Vienna Convention on the Law of Treaties, 1969***. The Articles 31, 32 and 33 of the convention lay down the rules for interpretation of these treaties. The commentaries by OECD and UN based on respective models also provide material for interpretation of the treaties. The terms and expressions, if not defined in the treaties, take their meaning from respective domestic law in case they are defined there.

Q. 36 Write a short note on the impact of colonialism on the Indian industry in the pre-independence period.

Ans.

- The first half of the 19th century saw a sudden and quick collapse of urban handicrafts – railways made it even faster.
- The second half of 19th century saw the entry of modern industries but the pace was very slow – low technology and confined to **cotton** and **jute,** iron/steel, came up in 1907 while sugar, cement and paper industries and a few engineering firms came up in the 1930s – still by 1946, cotton and jute textiles accounted for nearly 30% per cent of all worker employed in factories [CEHI].[3]
- After 1918, modern industry developed quite fast but its growth rate was just 3.8 per cent and had little impact on overall economic situation as its share in the national income was at 7.5 per cent by July 1947 [A. Maddison] in 1913 it was 3.8 per cent [CEHI].

- Modern industries barely compensated for the displacement of traditional handicrafts.
- In 1939 only 2 million were employed in industries (population 389 m.)
- A virtual absence of ***capital*** o r ***producers goods*** industry – relying almost wholly on imported machinry and tools (89.8 per cent).
- Banking and insurance grossly underdeveloped. Without simultaneous industrialisation, the growth of *railways* further colonised India and they served the British cause.
- Till 1930s, foreign capital dominated after 1918 – giant MNCs entered (Unilever, Imperial Chemical Industries, Dunlop and GM).

Foreign capital did 'drain' capital from India in place of promoting investment, we may see the *three* chief features:

(i) Contributed to 'the guided underdevelopment of India by concentrating on the production and export of raw materials and food stuffs.
(ii) Focused the sectors which catered to foreign markets and not to India's home market.
(iii) The 'multiplier effects' in terms of income, employment, capital, etc. were largely exported back to the developed countries.

Overall, industries were during encouraged the colonial rule but for the service to the colonial interests, not India – just a tool to drain out wealth, from India.

Q. 37 'Financial development facilitates real economic growth'. In the light of the statement discuss the situation of bond market in India.

Ans. The *Economic Survey 2011-12* raises its concerns for weak 'bond market' in India with this statement of the Australian economist Schumpeter- the issue was raised by the last *Economic Survey*, too. And the latest ***Economic Survey 2012-13*** has also recommended for its strengthening. The Survey highlights the passages from the latest research which prove the idea that to propel economic growth it is necessary to put a strong financial market in place – its depth and diversity in the instruments of raising long-term money support inclusive growth.

Long-term financial needs of Indian firms are mainly met by the banks in India (17.8 per cent, 2011-12) and the bonds play a negligible role. Basically, the vacuum created by the bond market has been compensated by foreign borrowings (costly and secured) by Indian firms which rose sharply in the last decade.

There are some ***reasons*** why the bond market has not developed adequately:

(i) One reason has to do with what economists call 'multiple equilibria'. This is a situation when due to underdeveloped bond market, the instrument lacks liquidity – lesser number of interested buyers and sellers of the bonds.
(ii) Underdeveloped *mechanism of information* about the corporate houses who could issue bonds- information is delayed, inadequate and insufficient.
(iii) A general *erosion of faith* in the corporate world due to recent cases of scams and scandals which involved the politicians, bureaucracy and the corporate houses, too.

Low penetration of the 'unsecured borrowing' (Corporate bonds) provide less incentives to the entrepreneur and discourages investment and growth. Raising funds via bonds are not only easier but

faster and safer in comparision to the 'secured loans' provided by the other segments of the organised finacial sector (banks, security market, debentures). Entrepreneurship needs free and quicker means of funds' availability to flourish – India is a typical case of least explored economy on this count. As India decides to garner $500 billion investment from the private sector in the *12th Plan* period, this is the right time to strengthen the corporate bond market in the country.

Q. 38 Write a current note on the recent steps taken by the government in the area of agricultural extension services.

Ans. Governments have always felt that India lacks a strong extension services in the agriculture sector. In recent years, the GoI has launched many effective programmes/schemes in this regard:

- The Support to State Extension Programmes for Extension Reforms Scheme was launched in 2005-06, aiming at making the extension system 'farmer driven' as well as accountable to farmers by providing for new institutional arrangements for technology dissemination. This has been done through setting up of Agricultural Technology Management Agencies (ATMA) at district level to operationalise the extension reforms;
- 'Mass media support' to agriculture focusing on Doordarshan infrastructure and All India Radio (AIR) broadcasting agriculture-related informations;
- Kisan Call Centres (KCC) to provide agricultural information to the farming community through toll free telephone lines;
- *Agri-clinic* and *agribusiness* centres by agriculture graduates to provide extension services to farmers on 'payment basis' through setting up of economically viable self–employment ventures, and information dissemination through *agri fairs*;
- *Extension Education Institutes* at *Nilokher* (Haryana), *Rajendra Nagar* (Andhra Pradesh), *Anand* (Gujarat), and *Jorhat* (Assam) are operating at 'regional level' to improve the 'skills and professional' competence of extension field functionaries of agriculture;
- There are ***model training courses*** on thrust areas of agriculture, horticulture, animal husbandry, and fisheries with the objective of improving the professional competence, upgrading the knowledge and developing technical skills; and
- ***MANAGE,*** Hyderabad, an apex Institute at the national level, provides training to middle and senior level officers of agriculture.

Q. 39 Write a contemporary note on the 'changing dynamics' of the global economy in reference to India.

Ans. The global economy has gone for a big change in its dynamics over the 'last two decades' – and has every potential to go for further change in the coming decades. The shares of major economies in global GDP, manufacturing, and trade suggest that there has been a marked change in the configuration of the world economy – visible by the following points:

- Sustained growth of a number of emerging economies, especially the BRICS economies, has resulted in an increase in their share in the global GDP.
- The value addition in the world economy has been moving away from advanced countries

towards what have been termed emerging economies. The decline in share is particularly marked in the case of the EU.

- The shift towards Asia has been significant and, within Asia, away from Japan to China and India.
- The *fivefold* increase in share of China in the global GDP has placed it as the second largest economy in the world. The increase in share of India, though less dramatic, is nevertheless of an order that places her as the ***fourth*** largest economy in PPP terms.
- The reduction in share of advanced economies, particularly from 2005, has been accentuated by the slowdown that followed the 'sub-prime crisis' in the United States, the eurozone crisis in 2010, and the near stagnation in Japan for nearly two decades on the one side and the significantly higher rate of growth in low and middle income countries, particularly the large countries like India and China, on the other.
- From the perspective of whether there has been a 'catch up' in per capita incomes across a larger set of countries, it is seen that the 'per capita income' (at PPP constant 2005 dollars) of 131 countries from 1980 to 2009 continued to increase for most of the period since the mid-1980s, except in the last two-three years.

The major changes in the *dynamics of the Indian economy* have been as given below:

- India has achieved faster growth from the 1980s – not only was this growth higher compared to its own past, it was also much faster than that achieved by a large number of countries. Between 1980 and 2010, India achieved a growth of 6.2 per cent, while the world as a whole registered a growth rate of 3.3 per cent.
- India's share in global GDP, (measured in terms of constant 2005 PPP international dollars) more than doubled from 2.5 per cent in 1980 to 5.5 per cent in 2010. Consequently, India's rank in per capita GDP showed an improvement from 117 in 1990 to 101 in 2000 and further to 94 in 2009, out of 131 countries (China improved its rank from 127 to 74 during the same period).

Underlying the relative decrease in share of advanced economies in the global GDP, there has been a marked shift in the *location of manufacturing.* This process was on in the 1990s, but got accelerated in the current decade. Again, the rise in the share of China is particularly significant while other emerging economies, namely Brazil, India, Indonesia have also moved up in terms of their share in world manufacturing. Even with the change in distribution of global GDP and manufacturing across countries, it needs to be noted that the advanced countries still account for a large share of industrial output, apart from being the repositories of technology and value added in services. The changing dynamics of the global economy has provided a good opportunity to India to expand its econimic presence more strongly.

Q. 40 Write a brief note on the recent steps taken by the Indian government regarding financial inclusion and literacy.

Ans. Financial inclusion plays a crucial role in inclusive development and sustainable prosperity as is being increasingly recognised and acknowledged globally. Large segments of population need to be part of formal payment system and financial markets. Financial inclusion would also broaden and

deepen financial savings and lead to higher economic development.

Previous initiatives: While financial sector policies in India have long been driven by the objective of increasing penetration and outreach, the goal of inclusion has eluded us. About 41 per cent of adult population remains unbanked and the number of loan accounts covers only 14 per cent of adult population. The previous initiatives included:

(i) The expansion of network of co-operative banks to provide credit to agriculture and saving facilities in rural areas,

(ii) Nationalisation of banks in 1969 and expansion of branches and

(iii) Creation of an elaborate framework of priority sector lending with mandated targets as part of a strategy to meet the savings and credit needs of large sections of the Indian population who had no access to institutional finance.

Given the sheer enormity of the challenge, however, the outcomes of these efforts have so far been mixed.

Recent initiatives include: (i) 'no-frill' account for retail purpose; (ii) simplified KYC (Know Your Customer); (iii) Credit counselling centre (GCC) facilities; (iv) use of NGOs and formation of SHGs; (v) Kisan credit cards services; and (vi) extension of Smart cards.

Every Union Budget since 2007-08 has laid down provisions for funding of financial inclusion goals. The *Rangarajan Committee* also spelt out priorities for meeting financial inclusion objectives. **Two** of the more important approaches in the recent times included the use of technology such as ***smart cards*** and ***mobile telephone banking***. The potential for their spread can be vast especially in combination with 'banking correspondence' approach launched recently.

Financial Literacy:[4] Any policy initiative seeking to afford greater access to financial services to a large segment of the population must necessarily address bridging the existing *knowledge gap* in financial education and literacy. Over the last decade or so, researchers all over the world, especially in the developed countries, have, therefore started to study and explore whether individuals are well-equipped to make financial decisions. Financial education and literacy assumes urgency in any given scenario. No wonder policymakers all over are increasingly taking note of this and directing their efforts to address it.

Q. 41 Write a note on the need and prospects of the proposed 'Infrastructure Debt Funds' (IDFs).

Ans. For setting up IDFs the broad guidelines were issued in September 2011 *aimed* to facilitate flow of funds into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust-based IDF would normally be a mutual fund (MF), while a company-based IDF would normally be an NBFC.

An IDF-NBFC would raise resources through issue of either 'rupee-' or 'dollar-' denominated bonds of minimum *five-year* maturity. The investors would be primarily domestic and off-shore institutional investors, especially insurance and pension funds which would have long-term resources. An IDF-MF would be regulated by the SEBI while an IDF-NBFC would be regulated by the RBI. Such entities would be designated as Infrastructure Debt Fund-Mutual Funds (IDF-MF) and Infrastructure Debt Fund-Non Banking Financial Company (IDF-NBFC). All NBFCs, including Infrastructure

Finance Companies (IFCs) registered with the bank may sponsor IDFs to be set up as MFs. However, only IFCs can sponsor IDF-NBFCs.

Eligibility parameters for NBFCs as sponsors of IDF-MFs include a minimum NOF (net owned fund) of Rs. 300 crore; CRAR (capital to risk-weighted assests ratio) of 15 per cent; net NPAs (non performing assets) less than 3 per cent; the NBFC to have been in existence for at least five years and earning profits for the last three years in addition to those prescribed by SEBI in the newly inserted *Chapter VI B* to the MF Regulations. Only NBFC-IFCs can sponsor IDF-NBFCs with prior approval of the RBI and subject to the following conditions:

- The sponsor IFC would be allowed to contribute a maximum of 49 per cent to the equity of the IDF-NBFC with a minimum equity holding of 30 per cent of the equity of IDF-NBFC, post investment, in the IDF-NBFC;
- The sponsor NBFC-IFC must maintain minimum CRAR and NOF prescribed for IFCs;
- There are no supervisory concerns with respect to the IFC.
- The IDF is granted relaxation in credit concentration norms and in risk weights.

Q. 42 Write a note on the 'Interest Subvention Relief to Farmers' programmes being run by the GoI.

Ans. Farmers in the country have been facing financial hardship due to several reasons – consecutive droughts, indebtness and crop failures – farmers' suicide have always been in news in the recent time. Consequent upon the announcement by the Union Finance Minister in Budget Speech 2006-07, public-sector banks, regional rural banks and rural co-operative credit institutions were advised that with effect from Kharif 2006-07, government would provide interest rate subvention of **2** per cent per annum in respect of short-term production credit up to Rs. 3.0 lakh. This subvention was available to public sector banks, regional rural banks and rural co-operatives on the condition that they made short-term credit available at **7** per cent per annum. In case of RRBs and rural cooperatives, this was applicable only to short-term production credit disbursed out of their own funds and did not include such credit supported by NABARD refinance.

Pursuant to the *Union Budget 2010-11* announcement, it was decided to provide interest subvention of 1.5 per cent per annum for short-term agriculture loans up to Rs. 3.0 lakh disbursed by public-sector banks, cooperatives, and RRBs. The additional subvention for prompt repayment has been enhanced to **2** per cent per annum so that the effective interest rate charged to such farmers is 5 per cent per annum up to Rs. 3.0 lakh. In the *Budget 2011-12*, the government of India proposed to provide interest subvention of 1.5 per cent per annum for short term agriculture loans up to Rs. 3.0 lakh disbursed by public sector banks, co-operatives and RRBs. The additional subvention for prompt paying farmers is proposed to be enhanced to 3 per cent per annum so that the effective interest rate charged to these farmers is 4 per cent per annum upto Rs. 3.0 lakh. The programme has also been continued by the *Union Budget 2013-14*.

Q. 43 Write a note on the advantage to India in the world of 'Wellness Tourism'.

Ans. Several studies have estimated the global market for medical tourism ranging from US$ 100 billion to US$ 150 billion. The Asian medical tourism market is being bolstered by initiatives taken

by the national governments, as also rising quality standards.

According to a study by the Organization for Economic Cooperation and Development (OECD), Thailand, India, Singapore, Malaysia, Hungary, Poland, and Malta are promoting their comparative advantage as medical tourist destinations. Singapore Medicine has been established under government-industry partnership to promote Singapore as a destination for advanced medical care. Malaysia has established the Malaysia Healthcare Travel Council to develop and promote the health-care and travel industry. Philippines has launched the Philippines Medical Tourism Programme and included medical tourism in the Investment Policies Plan. Thailand has been leveraging elements such as spas and alternative therapies in its promotional strategies for several decades, coupled more recently with state-of-the-art hospitals and skilled professionals.

Several features like cost-effective health-care solutions, availability of skilled health-care professionals, reputation for treatment in advanced health-care segments, increasing popularity of India's traditional wellness systems, and strengths in IT have positioned India as an ideal health-care destination. India, while strengthening its capabilities in modern health-care systems is also leveraging its inherent strengths in traditional health-care systems such as Ayurveda, Siddha, Yoga, Naturopathy, and Faith healing/Spiritualism. It also holds an edge over competitor countries with its mastery over techniques of 'concentration and 'mind control'.

Q. 44 During India's Struggle for Independence, 'Indian capitalist class was anti-socialist and bourgeois but it was not pro-imperialist'. Elucidate.

Ans. There has been a general misconception about the 'loyality' and 'stand' of the Indian capitalist class (industrialists, traders) throughout the freedom struggle – for which there were valid reasons:

- They never wanted their business to suffer so opposed the Civil Disobedience and Non-coperation Movements – seen going against Gandhi in particular and INC is general.
- They opposed 'socialism' and favoured 'capitalism' that is why they looked in opposition to the socialistic leanings of the INC.
- Due to above-given reasons the stand of the Indian capitalist class has been often seen as supportive to the Imperial Rule.

  But **objective analysis** of their stand proves it wrong:
- From mid 19^{th} century, Indian capitalists had their independent capital base and did not remain junior partners of foreign capital – which was antagonistic to the foreign capitalism class.
- The Bombay Plan (of a wide cross section of the leaders of Indian capitalist class) vehemently demanded land reform, co-operativisation of production, finance and marketing (like nationallist leaders).
- FICCI (1927) soon got relevance which by 1930s started talking of 'unequal exchanges' – the INC saw it as a favour against the fighting imperialist economic hegemony.
- By 1928, FICCI had clearly indicated of entering politics with 'nationalistic stand' – a general approach of strengthening the hands of those who were for freedom of the country.
- They were opposed to Civil Disobedience, reasons being – a prolonged movement could

unleash forces which may become revolutionary in a social sense (threatening capitalists) and a 'disregard for authority' could hamper the future government after getting Swaraj; hampered day-to-day business threating the very existence of the business class; followed constitutional process but not on the terms of the Britishers (participated in councils, conferences – which did show as if they were with the Imperial powers.

- By 1935, FICCI announced that without the INC approval or participation it would not get involved with the Imperial rule at any level – bycotted First Round Table Conference as it was not having Gandhi and the INC.
- By 1937, FICCI has started pressurising the British government to come out with a goal of 'self-rule' and informed them that if it was not the outcome, the Congress will go for 'direct action' which meant 'non-violent mass civil-disobedience'.
- The increase in radicalisation of the INC in 1930s (towards Left) made capitalists more active in politics – but it did not push them into the 'lap of imperialism' (as predicted by contemporary radicals)which happened in some other colonial and semi-colonial countries, instead they evolved a subtle, many-sided strategy to contain the Left but no part of it went for imperialisits.
- In 1927 the capitalist class (via FICCI) refused supporting the government on the Public Safety Bill which tried to contain the communists (since they were against the imperial government) – but they did not want to destroy capitalism as a force.
- By 1943 the capitalists also realised the need for socialistic reforms – 'Post War Economic Development Committee' was set up by them which drafted the 'Bombay Plan' – with a general aim of incorporating 'whatever was sound and feasible in the socialist movement' without capitalism surrendering any of its essential features (says G L Mehta, *FICCI President*).

[Based on the CEHI, op. cit.; Bipan Chandra; Angus Maddison]

Q. 45 'India's economic policies are neo-liberal.' Examine.

Ans. The process of economic reforms started by India in 1991 was a follow-up to liberal policies influenced by current world ideas of neo-liberalism via the IMF (as it agreed with Washington Consensus, 1985). This is why critics of the reform process call Indian economic policies neo-liberal (it was also remarked by the *Supreme Court of India*, in one of its judgements in 2012).

Through reform, India started redefining the economic role of state in the economy– a predominant role was assigned to the 'private sector' – but the state today has a different and bigger role. We may cite some examples to show why India's policies are still not neo-liberal:

(i) State still manages majority stakes in the PSUs and many 'very big PSUs' have been newly set up.

(ii) Higher degree of regulation gives more economic authority to the government.

(iii) Even after liberalisation, India is ranked very low in being a liberal economy what to ask of a neo-liberal economy.

(iv) Subsidies are still on the higher side.

(v) Government expenditure on education, healthcare, social security has increased hugely post-1991.

(vi) Even liberal policies of the government are under several official checks and controls.

(vi) Had India followed neo-liberal policies, it would also have faced some financial crisis after the US 'sub-prime' crisis.

Thus, India's economic polices cannot be called neo-liberal – liberal, yes.

Q. 46 What are tax-havens and how they are promoting corruption in India?

Ans. 'Tax havens' are nation-states or dominions imposing 'low' or 'no taxes' on personal and corporate incomes, and as a consequence tend to attract wealthy individuals and corporates seeking to minimise their tax liabilities. Other than saving taxes, these havens are also used as a safe hub for parking 'black money' created in different countries. As per the data of the OECD, there are at present over 70 such destinations in the world – popular ones are British Virgin Islands, Cayman Islands, Cook Islands, Dubai, Isle of Maw, Liechtenstein, Marshall Islands, St. Kitts and Nevis, Switzerland, Mauritius, US Virgin Islands, etc. The tax havens are promoting corruption in India in so many ways which may be understood in the following way:

- They have emerged safe hubs for parking money earned in India.
- As there are such parking centres, the black money individuals and corporates generate in India are easily hidden there with no risk of getting caught.
- Many Indian corporates have their operations in such places which they use for 'transfer pricing'.
- The parked funds get back to India in the form of 'hedge funds' destabilizing the economy.
- As corruption is supposed to be very high in India, even politicians are believed to park their black money there.
- They accelerate hawala, bribery, etc. in India.

Recently, we have seen some effective action being taken by the victims nations to unearth their funds parked in these havens such as the USA, Germany and many of the OECD nations. Recently, the Government of India has also started such initiatives.

Q. 47 Write a note on the restructuring of the Centrally Sponsored Schemes into the new Additional Central Assistance implemented from the financial year 2013-14.

Ans. The Planning Commission (PC), with the commencement of 12th Plan, proposed 'rationalisation' and 'restructuring' of the 16 Centrally Sponsored Schemes (CSS) into Additional Central Assistance (ACA) Schemes. The proposal has been accepted by the Cabinet and the ACA will become effective from 2013-14. As per the PC, together with the government this will 'improve the efficiency' of the Schemes. After the restructuring, the situation will be as below.

- It will give more flexibility to the states to utilise the funds,
- It will also give the Planning Commission 'absolute control' over the quantity of money to be

released.

- The CSS funds till now were routed through the concerned Central ministries,
- Under the new set up the Planning Commission will release the funds *directly* to the states on the recommendation of the Ministry of Finance.
- The concerned ministries will now only *monitor* the implementation of the schemes, which would be evaluated by an external agency.
- The schemes to be restructured include *flagship programmes* such as the Integrated Child Development Scheme, the Mid Day Meal Scheme, the Sarva Shiksha Abhiyan, the Mahatma Gandhi National Rural Employment Guarantee Scheme, the Indira Awas Yojana, the Pradhan Mantri Gram Sadak Yojana, and the yet-to-be launched National Health Mission.
- Some other important schemes to be restructured are – the Rashtriya Krishi Vikas Yojana, the Rajiv Gandhi Drinking Water Mission and Sanitation Mission, the Backward Regions Grant Fund, and the National Rural Livelihood Mission.

Though states would welcome the *flexibility* in using the funds if based on a normative formula, experts point out that the Planning Commission would have total discretion over funding to the states and each could be treated differently. The present funding structure of ACA varies from one scheme to another.

The point to be noted here is that most of the states of India since the last many years are fiscally broke and they have to tow the lines of the PC to get developmental funds from the Centre. All developmental funds accruing to the states are being 'monitored' by the PC on the 'guidelines' of the 'Monitorable Targets' set by the states themselves. In such a situation, for greater efficiency, accountability and outcome, the restructuring looks logical.

Meanwhile, the political parties. Communist Party) have been demanding ICDS and Midday meal to be made *statutory rights* of the people Experts fear the new funding pattern could be used as a 'political tool' by the Centre to discriminate between states on the basis of the party in power.

Q. 48 Write a short note on recent steps taken by the GoI to make the public sector banks compliant to the Basel III norms.

Ans. As capital is a key measure of banks' capacity for generating loan assets, and is essential for balance sheet expansion, the GoI has regularly invested additional capital in the PSBs to support their growth and keep them financially sound so as to ensure that the growing credit needs of the economy are adequately met. A sum of Rs. 12,000 crore was infused in seven PSBs during 2011-12 to enable them to maintain a minimum Tier-I CRAR of 8 per cent and also to increase shareholding of the GoI in them.

In *2012-13* also, the government has infused capital in PSBs to augment their Tier-I capital so that they maintain their Tier-I CRAR at a comfortable level and remain compliant with the stricter capital adequacy norms under Basel III . This will also support internationally active PSBs in their national and international banking operations undertaken through their subsidiaries and associates. An amount of Rs. 12,517 crore was allocated by the GoI for the year 2012-13 on *January 10, 2013*. The ***High Level Committee*** to assess the capitalisation of PSBs in the next 10 years, headed by the Finance Secretary has recommended various options for funding of PSBs. Given the budgetary constraints, it

may not be feasible for the government to infuse huge sums into the PSBs. This is why the committee has recommended the formation of a *'non-operating financial holding company' (HoldCo)* under a special *act of Parliament* with the following key objectives –

(i) To act as an investment company for the GoI;

(ii) To hold a major portion of the GoI's holdings in all PSBs;

(iii) To raise long-term debt from domestic and international markets to infuse equity into PSBs; and

(iv) To service the debt from within its sources.

Due to weakening of the RRBs, their sponsor banks have been incurring huge NPAs. RRBs have played a pivotal role in credit delivery in rural areas, particularly to the agriculture sector – to enhance their outreach and provide banking services more effectively to rural masses, RRBs need to undertake a continuous process of technology and capital upgradation. With a view to bringing the CRAR of RRBs up to at least 9 per cent, ***K. C. Chakrabarty Committee*** recommended recapitalization support to the extent of Rs. 2,200 crore to 40 RRBs in 21 States. Pursuant to the recommendation of the Committee, recapitalization amount is to be shared by the stakeholders in proportion to their shareholding in RRBs, i.e. 50 per cent central government, 15 per cent concerned state government, and 35 per cent the concerned sponsor banks. The re-capitalisation will continue upto March 2014.[5]

Q. 49 Write a brief note on the recently released FSLRC Report.

Ans. The *Justice B. N. Srikrishna* headed Financial Sector Legislative Reforms Commission (FSLRC) handed over its report *end-March 2013* – it was set up March 2011 *for examining* the regulatory structure and the laws governing the financial sector. The 10-member committee had a broad mandate covering all financial services as well as everything currently overseen by any financial regulator. Broadly, the commission has recommended what can be called a changeover from an 'area-based' division of regulators to a 'task-based' division. Major highlights of the recommendations are as follows:

(i) Today, each agency like the Sebi or the IRDA or the FMC looks after one type of financial service or one area – this would be replaced by a horizontal structure whereby the basic regulatory and monitoring functions of all areas would be done by a Unified Financial Agency (UFA).

(ii) All consumer complaints, regardless of the area will be handled by a Financial Redressal Agency (FRA).

(iii) There will be a single tribunal, the Financial Sector Appellate Tribunal (FSAT) which will hear appeals regarding the entire sector.

(iv) There are also three other agencies in the recommendations, along with the Reserve Bank of India which will continue to oversee banking.

The horizontal structure will serve the interests of the consumers of financial services (of individuals and businesses, both) much better. For one, it should *eliminate regulatory arbitrage* – the recent IRDA vs SEBI spat on ULIPs happened because the two agencies' views on the characteristics of investment products were very different. Another advantage of the horizontal structure would be that

consumer complaints about a sector would get separated from the regulator. This is important because a certain class of consumer complaints have mistakes or oversights by the regulator at their root. Recognising this root cause means admitting to its own flaw, something that is hard for any organisation.

Q. 50 Analyse the reasons why inflation Continues to Persist.

Ans. As per the *Economic Survey 2012-13*, inflation in protein foods, particularly eggs, meat and fish, and in fruits & vegetables has persisted because of *changes in dietary habits* and *supply constraints*:

- Long time series data from National Accounts on *PFCE* (private final consumption expenditure) indicate a structural shift in per capita consumption.

  The share of food consumption in total consumption has declined over time, from an average of 51.34 per cent during 1950-60 to an average of 27.17 per cent during 2007-12.
- Average annual growth in per capita food consumption at 0.94 per cent during 1950-2012 has been significantly lower than the overall growth in consumption averaging 1.84 per cent. The consumption of protein foods, though increasing more slowly than the increase in PFCE, had a growth of 1.50 per cent during 1950-2012, higher than the growth of overall expenditure on food. Therefore, the share of protein foods within overall food expenditure increased from 26.28 per cent during 1950-60 to 33.71 per cent during 2007-12.
- A similar decline in expenditure on food, relative to that in other commodities and services has been as expected, associated with rising income levels.
- Average annual growth of per capita expenditure during 1950-2011 was 2.40 per cent for non-food group. Within non-food commodities and services, average annual growth was 5.53 per cent, 3.97 per cent, 3.60 per cent and 3.42 per cent for transport and communication; recreation and education; medical and health care; and miscellaneous goods and services, respectively. Growth in expenditure for these sub sectors significantly exceeded the growth in expenditure on food. *Post reform* period (1992-93 to 2010-11) has shown a faster shift in consumption expenditure.
- An *increase in income* made this desirable shift in consumption feasible. At national level, per capita income, adjusted for inflation continued to rise.
- There was also a significant increase in rural wages. Rural wages in nominal terms went up by an average of over 18 per cent from 2008-09. Inflation-adjusted rural wages also went up by 7.5 per cent during this period.
- The ***input costs*** for producers in both the food and non-food segments, as reflected in the prices of feed, fodder and other inputs also increased. An increase in Minimum Support Price (MSP), while necessary to ensure remunerative returns to farmers, raised the floor prices and also contributed to the rise in input prices.

Q. 51 Briefly describe the recent steps taken by the GoI in the area of sugar sector reforms.

Ans. India is the largest consumer and second largest producer of sugar after Brazil. Sugar and Sugarcane are notified as essential commodities under the Essential Commodities Act 1955. The production of sugarcane during 2012-13 is estimated at 334.54 million tonnes. However, the Indian sugar sector suffers from policy inconsistency and unpredictability. The Sugar industry in India is over-regulated and prone to *cyclicality* due to price interventions. Deregulation of the sugar industry has been widely debated for a long time. From a purely economic point of view, greater play of market forces would provide better prices and serve the interests of all stakeholders. The government should come into the picture only in situations where absolutely necessary. Export bans and controls could be replaced with small variable external tariffs to stabilise prices.

A report on *'Regulation of the Sugar Sector in India: The Way Forward'* has been submitted by the Committee under the chairmanship of Dr C. Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister – the measures suggested are as follows –

(i) phasing out cane reservation area;

(ii) dispensing with minimum distance criteria;

(iii) dispensing with the levy sugar system;

(iv) states that want to provide sugar under the PDS may procure it from the market according to their requirement, fix the issue price and subsidize from their own budgets (Till April 4, 2013, when the GoI 'decontrolled' the sugar industry from the burden of 'levy' to the tune of 10 per cent of their total production, there was an implicit cross-subsidy on account of the levy as sugar mills were under a transition). The Report suggested some level of central support to help states meet the cost to be incurred on this account may be provided for a transitory period (which has been announced on April 4, 2013);

(v) dispensing with the regulated release mechanism (of non-levy) sugar;

(vi) stable trade policy;

(vii) no quantitative or movement restrictions on byproduct like molasses and ethanol and dispensing with compulsory jute packing.

(viii) a stable, predictable, and consistent policy reforms to be brought about in a fiscally neutral manner and issues considered for implementation in a phased manner.

In the meanwhile, following on the path of ongoing *'factor market reforms'* the GoI decontrolled the sugar industry in *April 2013* – effective for the 'sugar year' September 2012 - August 2013. It abolished the decades-old practice of regulating 'how much sugar a mill can sell in the open market' and the 'levy' system in which a company is forced to sell 10 per cent of the output at a loss to the FCI for supplies through the PDS (Public Distribution System) – they will be no more under the levy obligation. The *next move* of reform may be 'linking sugar and sugarcane prices'.

To continue subsidised supply to the poor, states will now have to buy sugar at market rates and maintain the existing PDS sale price of Rs 13.50 per kg, which has not been revised for a decade and is substantially lower than the average market price of Rs. 35 per kg.

Q. 52 Describe the role of 'energy pricing' and the recent steps taken by the government in reforming the sector.

Ans. The economic role of rational energy pricing can hardly be under-estimated. Rational energy prices provide the right signals to both the producers and consumers and lead to a demand-supply match, providing incentives for reducing consumption on the one hand, and stimulating production on the other. Aligning domestic energy prices with the global prices, especially when large imports are involved, may be ideal option as misalignment could pose both micro- and macroeconomic problems. At microeconomic level, underpricing of energy to the consumer not only reduces the incentive for being energyefficient, it also creates fiscal imbalances. Leakages and inappropriate use may be the other implications. Underpricing to the producer reduces both his incentive and ability to invest in the sector and increases reliance on imports. Over the years, India's energy prices have become misaligned and are now much lower than global prices for many products. The extent of misalignment is substantial, leading to *large untargeted subsidies*. Several initiatives have been taken by the GoI for rationalising the energy prices in different sectors –

- The Integrated Energy Policy has outlined the broad contours of the pricing system for coal. The *pricing of coal* is done now on gross calorific value (GCV) basis with effect from January 31, 2012, replacing the earlier system of pricing on the basis of useful heat value (UHV) which takes into account the heat trapped in ash content also, besides the heat value of carbon content. The revision in the GCV is likely to increase the prices of domestic coal to some extent, but this is a desirable adjustment because domestic thermal coal, adjusted for quality differences, continues to be underpriced.
- In case of petroleum products pricing, the government dismantled the Administered Pricing Mechanism in 2002. This decision, however, was not fully implemented and domestic pass through of global price increases remained low for petrol, diesel, kerosene, and LPG – in June 2010, the government announced that the *price of petrol was fully deregulated* and the oil companies were free to fix it periodically.
- In *January 2013*, the government announced the new roadmap providing for a gradual price increase for reducing *diesel under-recoveries*.
- Admissibility of subsidized number of liquefied petroleum gas (LPG) cylinders and prices of LPG have also recently been revised. Pricing of gas is presently done under the New Exploration Licensing Policy (NELP). The government provides the operator freedom to sell the gas produced from the NELP blocks at a market-determined price , subject to the approval of pricing formula. The government is reviewing pricing under the PSC (price sharing contract) to clarify the extent to which producers will have the freedom to market the gas.

Q. 53 What is Marginal Standing Facility and what are its objectives? Describe in brief.

Ans. The MSF (Marginal Standing Facility) is a new scheme announced by the RBI in its *Monetary Policy, 2011-12*. Under this scheme, banks can borrow overnight upto 1 per cent of their net demand and time liabilities (NDTL) from the RBI, at the interest rate 1 per cent (100 basis points) higher than the current repo rate.

The MSF would be the last resort for banks *once they exhaust* all borrowing options, including the liquidity adjustment facility by pledging through government securities, which has lower rate (i.e.,

repo rate) of interest in comparison with the MSF. The MSF would be a **penal rate** for banks and the banks can borrow funds by pledging government securities within the limits of the statutory liquidity ratio. The scheme has been introduced by RBI with the main aim of reducing volatility in the overnight lending rates in the inter-bank market and to enable smooth monetary transmission in the financial system.

Banks can borrow through MSF on all working days except Saturdays, between 3.30 and 4.30 p.m. in Mumbai where RBI has its headquarters. The minimum amount which can be accessed through MSF is Rs.1 crore and in multiples of Rs.1 crore.

MSF represents the upper band of the interest corridor and reverse repo (7.25 per cent) as the lower band and the repo rate in the middle. To balance the liquidity, RBI would use the sole independent policy rate which is the repo rate and the MSF rate automatically adjusts to 1 per cent above the repo rate.

Similar to India's MSF the ECB (European Central Bank) also offers standing facilities called *marginal lending facilities* (MLF) and the Federal Reserve (the US Central Bank) has *discount window systems* (DWS). Like the MSF, the secondary credit facility made available by the Federal Reserve to the depository institutions in USA is typically overnight credit on a very short term basis at rates above the primary credit rate.

The effectiveness of standing facilities in reducing volatility have been examined by many scholars and certain studies have pointed out that in the Federal Reserve System in the United States, the design of the facility decreases a bank's incentive to participate actively in *interbank market* (i.e., India's Call Money Market) due to the perceived stigma from using such facility. This in turn reduces the effectiveness of standing facility in reducing interest rate volatility.[6]

Q. 54 What are Nidhis and how are they regulated in India?

Ans. Nidhi in the Indian context means 'treasure'. However, in the Indian financial sector, it refers to any *mutual benefit society* notified by the Central / Union government as a Nidhi Company. They are created mainly for cultivating the habit of *thrift* and *savings* amongst its members. The companies doing Nidhi business, viz. borrowing from members and lending to members only, are known under different names such as *Nidhi, Permanent Fund, Benefit Funds, Mutual Benefit Funds* and *Mutual Benefit Company.*

Nidhis are more popular in ***South India*** and are highly localised single office institutions. They are mutual benefit societies, because their dealings are restricted only to the members; and membership is limited to individuals. The principal source of funds is the contribution from the members. The loans are given to the members at relatively reasonable rates for purposes such as house construction or repairs and are generally secured. The deposits mobilised by Nidhis are not much when compared to the organised banking sector.

Nidhis are companies registered under the Companies Act, 1956 and are regulated by Ministry of Corporate Affairs (MCA). Even though Nidhis are regulated by the provisions of the Companies Act, 1956, they are exempted from certain provisions of the Act, as applicable to other companies, due to limiting their operations within members.

Nidhis are also included in the definition of Non- Banking Financial companies or ***(NBFCs)*** which

operate mainly in the *unorganised money market*. However, since 1997, NBFCs have been brought increasingly under the regulatory ambit of the RBI. Non-banking financial entities partially or wholly regulated by the RBI include:

(i) NBFCs comprising equipment leasing (EL), hire purchase finance (HP), loan (LC), investment (IC) [including primary dealers (PDs) and residuary non-banking (RNBC) companies;

(ii) Mutual benefit financial company (MBFC), i.e. *nidhi company*;

(iii) Mutual benefit company (MBC), i.e. potential nidhi company; i.e., a company which is working on the lines of a Nidhi company but has not yet been so declared by the Central Government; has minimum net owned fund (NOF) of Rs. 10 lakh, has applied to the RBI for certificate of registration and also to Department of Company Affairs (DCA) for being notified as Nidhi company and has not contravened directions / regulations of RBI/DCA.

(iv) Miscellaneous non-banking company (MNBC), i.e., *chit fund company*.

Since Nidhis come under one class of NBFCs, RBI is *empowered* to issue directions to them in matters relating to their deposit acceptance activities. However, in recognition of the fact that these Nidhis deal with their shareholder-members only, RBI has exempted the notified Nidhis from the core provisions of the RBI Act and other directions applicable to NBFCs. As on date (*February 2013*), RBI does not have any specified regulatory framework for Nidhis.

Q. 55 What are Chit Funds and how are they regulated in India?

Ans. Recently, chit funds was in news after the Kolkata-based *Saradha Chit Fund* scam came to light. Chit funds (also known by their other names such as – *Chitty, Kuri, Miscellaneous Non-Banking Company*) are essentially 'saving institutions'. They are of various forms and lack any standardised form. Chit funds have regular members who make periodical subscriptions to the fund. The periodic collection is given to some member of the chit funds selected on the basis of previously agreed criterion. The beneficiary is selected usually on the basis of bids or by draw of lots or in some cases by auction or by tender. In any case, each member of the chit fund is assured of his turn before the second round starts and any member becomes entitled to get periodic collection again. Chit funds are the Indian versions of 'Rotating Savings and Credit Associations' found across the globe.

Chit fund business is regulated under the Central Act of *Chit Funds Act, 1982* and the Rules framed under this Act by the various State Governments for this purpose. Central Government has not framed any Rules of operation for them. Thus, Registration and Regulation of Chit funds are carried out by *State Governments* under the Rules framed by them. Functionally, Chit funds are included in the definition of Non- Banking Financial Companies by RBI under the sub-head *miscellaneous non-banking company* (MNBC). But RBI has not laid out any separate regulatory framework for them.

Official Definition: As per the Chit Funds Act 1982, chit means 'a transaction whether called *chit, chit fund, chitty, kuri* or by *any other name* by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of *grain* instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount'. A transaction is not

a chit, if in such transaction –

(i) Some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or

(ii) All the subscribers get the chit amount by turns, with a liability to pay future subscriptions.

Note: The Model Answers have been prepared by consulting a restricted list of references only to make them relevant and useful for the competitive examinations conducted by the various government bodies. Following main references have been consulted: various volumes of ***Economic Survey;*** *various volumes of* ***India*** reference manual; last three volumes of the ***India Development Report.*** Ministerial sources, websites of ***RBI*** and the **Planning Commission.**

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1. The answer given above looks bigger – here, the complete picture has been presented, and the readers are suggested to cut it short as per their requirement – as per the demand of the question. Questions are generally asked in parts i.e. only the 'Budgetary measures', Monetary measures, Administrative measures, etc.
2. 'Long-term investors' include SEBI-registered 'sovereign wealth funds' (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks.
3. Dharma Kumar (ed.), Cambridge Economic History of India, vol 4, Cambridge, CUP, 1983.
4. ***Some extra information on the topic:*** In the **UK**, the Financial Services Authority has launched a big campaign to improve the financial skills of the population and enable a better appreciation of risks and rewards inherent in financial instruments and transactions. The **US Treasury**, which established its Office of Financial Education in 2002, is working to promote access to the financial education tools. The Financial Literacy and Education Commission, established by Congress in 2003 was created to improve financial literacy and education. In Australia, the Government established a National Consumer and Financial Literacy Taskforce in 2002. In **Malaysia**, the Financial Sector Master Plan, launched in 2001, includes a 10-year consumer education programme. The Monetary Authority of **Singapore** has launched a national financial education programme (Money SENSE). A nationwide, coordinated effort was also required in **India** and the Financial Stability and Development Council (FSDC) is a step forward in this direction. It is expected that this new initiative will help adequately address the challenge of financial inclusion and literacy. Idioms and metaphors of development economics keep on changing from time to time. Today, new financial sector initiatives in a country like ours – be it in the form of prompt and innovative policy responses from the Government, central bank, other authorities or be it in the form of implementation efficiency and inventiveness from the varied players – need to explicitly prioritise both financial inclusion and financial education and literacy.
5. Basel III norms prescribe a minimum regulatory capital of 10.5 per cent for banks by January 1, 2019. This includes a minimum of 6 per cent Tier I capital, plus a minimum of 2 per cent Tier II capital, and a 2.5 per cent capital conservation buffer. For this buffer, banks are expected to set aside profits made during good times so that it can be drawn upon during periods of stress.
6. The write-up is based on – *the RBI's Credit & Monetary Policy, 2011-12* (in which the Scheme was introduced); and the *European Central Bank*, Frankfurt, Germany and *Federal Reserve System* (also known as the Federal Reserve, and informally as the *Fed*) Washington, DC, USA.

24

ECONOMIC CONCEPTS AND TERMINOLOGIES

(Reference to selected terms related to Indian Economy)

*Concepts are the constituents of thoughts – consequently, they are crucial to such psychological processes as categorization, inference, memory, learning, and decision-making.**

* See Eric Margolis and Stephen Laurence, 'Concepts', in the Edward N. Zalta ***The Stanford Encyclopedia of Philosophy***, Metaphysics Research Lab, Centre for the Study of Language and Information (CSLI), Stanford, USA, 2012.

ACCRUAL BASIS

An accounting method which considers revenues and expenses as they accrue, even though cash would not have been received or paid during the period of accrual.

ACTIVITY RATE

The labour force of a country is known as the activity rate or *participation rate*. It is in per cent and always a proportion of the total population of the country–the economically active population. This rate varies from one country to another depending upon several factors such as school leaving age, retirement age, popularity of higher education, social customs, opportunities, etc.

ADRs

ADR stands for American Depository Receipt, which enables investors based in the USA to invest in stocks of non-US companies trading on a non the US stock exchange. ADRs are denominated in dollars. Simply put, US brokers purchase shares of a foreign company, say Infosys (on behalf of their clients). ADRs are subsequently listed on US stock exchanges.

ADRs can be sponsored or unsponsored. Sponsored ADRs are those in which the company actively participates in the process. Sponsored ADRs can be Level I, Level II or Level III. There are also what are called Rule 144A. The ADRs were first offered in the US in the 1920s. A number of Indian companies have issued ADRs. Infosys Technologies was the *first* Indian company to use the ADR route.

The terms *ADR* and *ADS* are often used interchangeably. The individual shares representeted by an ADR are called American Depositary Shares (ADS).

To the company issuing ADRs, it provides access to the American market. A company can, therefore, raise additional resources. To an American investor, it provides the opportunity to invest in stock of companies not listed in the US. Huge operational, custodial, and currency conversion issues can come into play if the ADR route is not used.

ADS CONVERSION OFFER

Conversion of local shares into American Depository Shares (ADS) of a company is called an ADS conversion offer. It is managed by investment bankers, mainly large investment banks familiar with Indian and global markets The offer allows local investors to convert their shares into ADS and then sell it in US markets. The proceeds of the sale in the US markets is distributed to Indian investors in rupees after deduction of expenses incurred in the process. The company does not issue any new shares. Existing shares are converted into ADS. The scheme obviously can only be offered by companies listed on the Indian and US markets which is the case for many large Indian corporates.

American Depository Shares are usually traded at a premium to the underlying (Indian) share price.

If the share conversion offer takes place through the stock market in India, investors pay no long-term capital gains tax. A 10 per cent short-term capital gains tax is applicable. Investors, however, have to pay the securities transaction tax in the process. However, if the offer is not through the stock market system, then investors have to pay 30 per cent short-term capital gains tax with surcharge or 10 per cent long-term capital gains tax as applicable. Investors do not have to pay any securities transaction tax.

Companies do not issue new shares. Thus, the offer does not lead to any dilution of equity and earnings per share. They are making this offer to satisfy the demand for ADS traded in US markets. This allows companies to have new investors and creates visibility on the US stock exchanges. They also satisfy the local investor by offering an opportunity to sell their shares at a higher price than available locally on the Indian bourses.

ADVERSE SELECTION

One among the two kinds of the market failure often associated with insurance business which means doing business with the people one would have better avoided.

Adverse selection can be a problem when there is an asymmetry in information between the seller and the buyer of an insurance policy–as insurance will not be profitable when buyers have better information about their risk of claiming than does the seller of the insurance policy. In the ideal case, insurance premiums are set in accordance to the risk of a randomly selected person in the insured bracket (such as 40-year-old male smokers) of the population.

The other kind of market failure is *moral hazards* associated with the insurance sector.

AGRICULTURAL EXTENSION

Agricultural extension is a proper approach to motivate people to help themselves by applying agricultural research and development in their daily lives in farming, home making, and community living. It plays a vital role in community development. It is a two-way channel that brings scientific information to rural people and takes their problems to scientific institutes (for further research and development) for their solution.

In India, like many other developing countries, the role of agricultural extension is more than educational and it needs to deal with the human resource development of the agrarian population too, making it a comparatively tougher task than in the developed countries. The spread of information technology will serve a great purpose in this area.

AGRICULTURAL LABOURER

A person who works on another person's land for *wages* in money or kind or share is regarded as an

agricultural labourer. He or she has no risk in the cultivation, but merely works on another person's land for wages. An agricultural labourer has no right of lease or contract on land on which he/she works.

AGRICULTURAL MARKETS

Agricultural Markets are regulated and managed under the Agricultural Produce Market Act (APMC Act) enacted by the respective state governments. The Central government provides guidance and assistance in regulation and development of agricultural-produce markets. 7,521 markets have been brought under regulation upto March this year. To handle increasing quantity, more and more markets have been brought under regulation over the years. There were only 286 regulated markets in 1950 on an average. A regulated market serves 459 sq. km. but the National Commission on Agriculture recommended that a regulated market should serve farmers within a 5 km. radius and a command area of 80 sq. km.

ALPINE CONVERTIBLE BOND

An ACB (Alpine Convertible Bond) is a Foreign Currency Convertible Bond (FCCB) issued by an Indian company exclusively to the Swiss investors.

AMMORTISATION

Payment of a loan in installments by the borrower. It is usually done in an agreed period and every installment includes a part of the total loan plus the interest.

ANDEAN PACT

A regional pact to establish a common market link, started originally in 1969. At present it has Peru, Equador, Columbia, Bolivia, and Venezuela. The pact had almost collapsed by the mid-1980s due to regional, economic, and political instabilities and was re-launched in 1990 (the original member Chile was dropped and the new member Venezuela was added to it).

ANIMAL SPIRIT

'Confidence', considered as one of the essential ingredients of economic prosperity was called by J. M. Keynes as animal spirit. For Keynes, this is a 'naive optimism' by which an entrepreneur puts aside the fact of loss as a healthy man puts aside the expectation of death.

But from where does this animal spirit come has been a mystery–can it be created artificially from

outside or whether it is an innate thing some are born with, etc.

ANTITRUST

A category of the government policy which deals with monopoly. Such laws intend to stop abuses of 'market power' by big companies and at times to prevent corporate mergers and acquisitions that would strengthen monopoly. The US has such laws and recently it was in news when Microsoft was its target.

APPRECIATION

It shows increase in value and is used in economics in the following two senses:

(i) It is an increase in the price of an asset over time–such as price rises in land, factory building, houses, offices, etc. It is also known as *capital appreciation.*

(ii) It is an increase in the value of currency against any foreign currency or currencies. It is market-based if the economy follows the floating-currency exchange-rate system.

ARBITRAGE

Earning profits out of the price differences of the same product in different markets at the same time. For example, buying and selling any product, financial securities (as bonds) or foreign currencies in different markets/economies. As globalisation is promoting liberalised cross-border movement of goods and services around the world, arbitrage is prevalent today. To avoid arbitrage the WTO member countries (i.e.,, the official countries in the process of globalisation) are under compulsion to chalk out homogenous economic policies–and a level-playing field at the international level is emerging.

ARCS

Assets Reconstruction Companies (ARCs) acquire non-performing assets (NPAs) from banks or financial institutions along with the underlying securities mortgaged and/or hypothecated by the borrowers to the lenders. The ARCs then try and manage or resolve these NPAs acquired from banks. It can even infuse more funds in order to reconstruct the asset. If reconstruction is not possible and the borrower is unwilling to repay the loan, the ARCs *even sell* the secured assets.

While the basic principle of ARCs is the same everywhere–to acquire bad loans to resolve them, the essential difference is in the ownership of ARCs, public or private. After the Asian Crisis, countries like Indonesia, Korea, Malaysia, and Thailand have adopted government-owned and funded ARCs. The Philippines, on the other hand, has opted for private ARCs. India, too, has adopted the private

sector model of asset resolution. Here, ARCs are set up as non-governmental vehicles mostly with support from the banking sector and other investors. Also, India has opted for multiple ARCs, which helps in better pricing of bad loans, as opposed to the single ARC model followed in many countries. The RBI has already allowed licenses to three ARCs and some banks are also planning to float ARCs.

ARCs acquire NPAs by way of 'true sale', i.e., once an NPA has been sold, the seller has no further interest in that asset.

ARCs are a product of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**SARFAESI Act**). And they derive their asset resolution powers from this Act. The act provides full right to the lenders acting in majority (75 per cent of the total debt by value) to enforce the security in tersest (terms of the loan) without judicial intervention. Through buying out major lenders in a loan gone bad (to the extent of 75 per cent of value), through the mechanism mentioned earlier, an ARC is able to have recourse to SARFAESI Act and, thereby, acquire legal muscle to force settlement.

It is true that if a bank itself has 75 per cent of the total value of debt in an NPA or is able to buy out other and accumulate the same, then it also gets recourse to SARFAESI. In that sense, banks are at par with ARCs. That is why we now find that some banks are getting interest and acquiring bad assets, just like an ARC does. However, a bank's business is not to deal bad assets or try and reconstruct them. An ARC, on the other hand, is in the business of reconstructing bad assets, and has acquired skill and experience in asset resolution. It is able to do the same job better. Moreover, selling an NPA helps a bank to clean its balance sheet, too.

ASSET

Anything which has a 'money value' owned by an individual or a firm is an asset. It is of *three* types:

(i) *Tangible Asset:* All physical assets such as land, machinery, building, consumer durables (refrigerator, car, TV, Radio, etc.), etc. (*the assets which are in the material form*).

(ii) *Intangible Assets:* All non-physical/immaterial assets such as brand names, good-will, credit-worthiness, knowledge, know-how, etc.

(iii) *Financial Assets:* All financially valid valuables other than tangibles and intangibles such as currencies, bank deposits, bonds, securities, shares, etc.

ASSIGNED REVENUE

The term is used to refer to various tax/duty/cess/surcharge/levy etc., proceeds of which are (traditionally) collected by state government (on behalf of) local bodies (the PRIs), and subsequently adjusted with / assigned to the PRIs. Collection of such revenue is governed by relevant Acts of the local bodies.

Some examples of assigned revenue in India, include – entertainment tax, surcharge on stamp duty, local cess/surcharge on land revenue, lease amount of mines and minerals, sale proceeds of social

forestry plantations etc. State Finance Commissions recommend *devolution* of assigned revenue to local bodies on objective criteria, which may be specified by them in specific context.

AUTARKY

The idea of self-sufficiency and 'no' international trade by a country. None of the countries of the world has been able to produce all the goods and services required by its population at competitive prices, however, some tried to live it up at the cost of inefficiency and comparative poverty.

BACKWARDATION

A term of future trading which means a commodity is valued higher today (i.e., spots market) than in the futures (i.e., future market). When the situation is opposite, it is known as *contango.*

BACK-TO-BACK LOAN

A term of international banking, is an arrangement under which two firms (i.e. companies) in different economies (i.e. countries) borrow each other's currency and agree to repay (such loans) at a specified future date. Each company gets full amount of the loan on the repayment date in their domestic currency without any risk of losses due to exchange rate fluctuations. It has developed as a popular tool of minimising the exchange-rate exposure risk among the multi-national companies. This is also known as the *parallel loan.*

BAD DEBT

An accounting term to show the loans which are unlikely to be paid back by the borrower as the borrower has become insolvent/bankrupt. Banks might write off such bad debts against the profits of the trading as a business cost.

BADLA

An Indian term for 'contango' associated with the trading system in the stock market which is a postponement of either payments by the share buyer, or the person who needs to deliver the shares against the payment.

BALANCED BUDGET

The annual financial statement (i.e., the budget) of a government which has the total expenditures equal to the taxes and other receipts.

Most governments, in practice run unbalanced budgets, i.e., deficit budgets or surplus budgets–either the expenditures being higher or lower than the taxes and the other receipts, respectively. It is done to regulate the economic activities.

BALANCE OF PAYMENTS

A balance sheet of an economy showing its total external transactions with the world–calculated on the principles of accounting–is an annual concept.

BALLOON PAYMENT

When the final payment of a debt is more than the previous payments, it is balloon payment.

BASING POINT PRICE SYSTEM

A method of pricing in which a differential (i.e., varying) price is fixed for the same product for the customers of the different locations–nearer the customer, cheaper the product. This is done usually to neutralise the transportation cost of the bulky products such as cement, iron and steel, petroleum, etc.

BELLWETHER STOCK

A share which often reflects the state of the whole stock market. The technical analysts, associated with the stock market, usually keep a track-record of such shares and go on to forecast the future stock movements.

BFS

For the purpose of supervision and surveillance of the Indian financial system, a Board for Financial Supervision (BFS) was set up by the RBI in November 1994. The board supervises commercial banks, non-banking financial companies (NBFCs), financial institutions, primary dealers, and the Clearing Corporation of India (CCI).

BLACK-SCHOLES

A formula devised for the pricing of financial derivatives or options–made explosive growth

possible in them by the early 1970s in the US.

Myron Scholes and Robert Merton were awarded Nobel Prize for Economics for their part in devising this formula–the co-inventor Fischer Black had died (1995) by then.

BOND

An instrument of raising long-term debt on which the bond-issuer pays a periodic interest (known as *‘coupon’*). In theory, bonds could be issued by governments as well as private companies.

Bonds generally have a maturity period, however, some bonds might not have any definite maturity period (which are known as *‘Perpetual Bonds’*).

Bonds are supported/secured by collateral in the form of immovable property (i.e., fixed assets) while *debentures,* also used to raise long-term debt, are not supported by any collateral.

BOOK BUILDING

This is a public offer of equity shares of a company. In this process, bids are collected from the investors, in a certain price range fixed by the company. The issue price is fixed after the bid closing date depending on the number of bids received at various price levels. A company that is planning an initial public offer (IPO) appoints a merchant banker as a ‘book runner’. The company issues a prospectus which does not mention the price, but gives other details about the company with regard to issue size, the business the company is in, promotes and future plans among other disclosures. A particular period is fixed as the bid period. The book runner builds an order book, that is, collates the bids from various investors, which shows the demand for the shares. Prospective investors can revise their bid at any time during the bid period. On closure of the book, the quantum of shares ordered and the perspective prices offered are known. The price discovery is a function of demand at various prices, and involves negotiations between those involved in the issue. The book runner and the company conclude the pricing and decide the allocation to each member.

BRACKET CREEP

Increasing incomes due to inflation (via increased dearness allowances, individual income goes for an increase) pushes individuals into higher tax *brackets* and leaves them worse off (as their real income has not increased and their disposable income i.e. income after tax payments, falls) – this phenomenon is known as the bracket creep.

BROAD BASED FUND

This is a fund established or incorporated *outside* India, which has at least 20 investors with no single individual investor holding more than 49 per cent of the shares or units of the fund. If the broad

based fund has institutional investor (s), then it is not necessary for the fund to have 20 investors. Further, if the broad based fund has an institutional investor who holds more than 49 per cent of the shares or units in the fund, then the institutional investor must itself be a *broad based fund*.

In India, the entities, proposing to invest *on behalf of broad based funds*, are eligible to be registered as FIIs are – (i) Asset Management Companies, (ii) Investment Manager/Advisor, (iii) Institutional Portfolio Managers, (iv) Trustee of a Trust, and (v) Bank

BROWNFIELD LOCATION

A derelict industrial area that has been demolished to accommodate new industries. This is opposite to the *greenfield location* where a new industry is set up in a new area.

BUBBLE

The price rise of an asset unexplained by the fundamentals and still people interested in holding the assets. After the bursting of the bubble, assets cool down to their real prices.

BUDGET LINE

A line on the dual axis graph showing the alternate combinations of goods that can be purchased by a consumer with a given income at given prices.

BULLION

Precious metals such as gold, silver, and platinum that are traded in the form of *bars* and *coins* for investment purposes and are used for jewellery as base metals.

BUSINESS CYCLE

See the chapter with the same title.

BUSY & SLACK SEASONS

The monetary authorities face the challenge of keeping the growth rate as high as possible, at the same time putting burden of adjustment on luxury and unproductive consumption. Monetary policy is an instrument in this respect. However, the right policies may not be palatable to the political and fiscal authorities, which is a serious problem for the economy.

From May beginning to end-September is the *slack season* and from October beginning to end-April is the *busy season* of the ***Indian economy***. During the slack season, crops are generally sown. Agriculture and related businesses are slack and loans taken during the previous busy season tend to be returned. Consequently, the growth rate of money is low or negative. Governments usually borrow heavily during the slack season, since the demand for credit from the commercial sector is not very strong. Since there are no fresh crop arrivals in the market and the demand for crops is steady, the prices are expected to be generally upward in the slack season.

From October, the busy season commences and both agricultural and related industrial productions are high. Since crops arrive in the market during the busy season, prices generally are on the downward drift. It is the seasonal variation in the arrival of crops in the market, in the context of steady demand, that causes prices to fluctuate during the year.

The above pattern has been severely modified in recent years. The government borrows both during the slack and the busy seasons. Industry too is active in both the seasons. Because of greater storage and stocking facilities, the variations in the flows o f agricultural products have been reduced. Money supply expands continuously and prices are generally up throughout.

BUYER'S MARKET

A short period of market situation in which there is excess supply of goods/services forcing price fall to the advantage of the buyers.

BUYOUTS

Private equity (PE) investors participate in two types of buyouts of firms (a PE-backed buyout simply means that the PE investor takes a controlling stake i.e. between 50–100 per cent in a company):

(i) *Management Buyout (MBO):* In such buyouts, the PE investor usually helps the existing management of the company to buy out the promoters of the company. In return, the PE investor takes a majority stake.

(ii) *Leveraged Buyout (LBO):* In such buyouts, a large portion of fund in acquiring the company is financed by debt–the normal ratio being 70 per cent debt and 30 per cent equity.

CAMELS

An acronym derived from the terms capital adequacy (C), asset quality (A), management (M), earnings (E), liquidity (L) and systems for control (S). The acronym is used as a technique for evaluating and rating the operations and performance of banks all over the world.

CAPITAL

Capital is one of the three main factors of production (*labour* and *natural resources* are the other two), classified into *physical capital* (i.e., factories, machines, office, etc.) and *human capital* (i.e., training, skill, etc.).

In a joint stock company, the capital has various specific terms showing different forms of the *share capital:*

(i) *Authorised Capital:* This is the amount of share capital fixed in the Memorandum of Association (MoA) and the article of association of a company as required by the Companies Act. This is also known as the *Nominal* or *Registered Capital.*

This is the limit (i.e., nominal value) upto which a company can issue shares. Companies often extend their authorised capital (via an amendment in the MoA) in advance of actual issue of new shares. This allows the timing of capital issue to be fixed in light of the company's need for new capital and the state of the capital market and allows share options to be excercised accordingly.

(ii) *Paid-up Capital:* The part of the authorised capital of a company that has actually been paid up by the shareholders. A difference may arise because all shares authorised may not have been issued or the issued shares have been only partly paid-up by then.

(iii) *Subscribed Capital:* The capital that has actually been paid by the shareholders (as they might have committed more than this to contribute). It means, the subscribed capital is the actually realised paid-up capital (paid-up capital is subscribed capital plus credit/due on the shareholders).

(iv) *Issued Capital:* The amount of the capital which has been sought by a company to be raised by the issue of shares (it should be kept in mind that this cannot exceed the authorised capital).

(v) *Called-up Capital:* The amount of share capital the shareholders have been *called* to pay to date under the phased payment terms. It is usually equal to the 'paid-up capital' of the company except where some shareholders have failed to pay their due installments (known as *calls in arrears*).

CAPITAL ADEQUACY RATIO

A regulation on commercial banks, co-operative banks and the non-banking financial companies to maintain a certain amount of capital in relation to their assets (i.e., loans and investments) as a cushion (shock-absorber) against probable losses in their investments and loans.

A concept devised by the Bank for International Settlements (BIS), Basel, the provision was implemented in India in 1992 by the RBI (for more detailed discussion see the chapter on 'Banking').

CAPITAL CONSUMPTION

The capital that is consumed by an economy or a firm in the production process. Also known as *depreciation*.

CAPITAL-OUTPUT RATIO

A measure of how much additional capital is needed to produce each extra unit of the output. Put the other way round, it is the amount of extra output produced by each unit of added capital. The ratio indicates how efficient new investment is in contributing to the growth of an economy.

A capital-output ratio of 3:1 is better to the 4:1 as the former needs only three units extra capital to produce one extra output in comparison to the latter which needs four units for each extra unit output.

CARBON CREDIT

Amidst growing concern and increasing awareness on the need for pollution control, the concept of carbon credit came into vogue as part of an international agreement, known popularly as the Kyoto Protocol. Carbon credits are certificates issued to countries that reduce their emission of GHG (greenhouse gases) which leads to global warming. It is estimated that 60–70 per cent of the GHG emission is through fuel combustion in industries like cement, steel, textiles, and fertilisers. Some GHGs like hydro fluorocarbons, methane, and nitrous oxide are released as byproducts of certain industrial process which adversely affect the ozone layer, leading to global warming.

Kyoto Protocol is a voluntary treaty signed by 141 countries including the European Union, Japan, and Canada for reducing GHG emission by 5.2 per cent below 1990 levels by 2012. However, the US, which accounts for one-third of the total GHG emission is yet to sign this treaty. The preliminary phase of Kyoto Protocol started in 2007 while the second phase starts from 2008. The penalty for non-compliance in the first phase is 40 Euro per tonne of CO_2 equivalent and in the second phase the penalty will be hiked to 100 Euros per tonne of CO_2.

The Kyoto Protocol provides for *three* mechanisms that enable developed countries with quantified emission limitation and reduction commitments to acquire greenhouse gas reduction credits. These mechanisms are Joint Implementation (JI), Clean Development Mechanism (CDM) and International Emission Trading (IET). Under *JI,* a developed country with a relatively higher costs of domestic greenhouse reduction sets up a project in another developed country which has a relatively low cost. Under *CDM,* a developed country can take up a greenhouse gas reduction project activity in a developing country where the cost of GHG reduction project activities is usually much lower. The developed country would be given credits for meetings its emission reduction target, while the developing country would receive the capital and clean technology to implement the project. Under *IET* mechanisms, countries can trade in the international carbon credit market. Countries with surplus credits can sell the same to those with quantified emission limitation and reduction commitments under the Kyoto Protocol.

The concept of carbon credit trading seeks to encourage countries to reduce their GHG emissions, as it rewards those countries which meet their targets and provides financial incentives to the others to do so as quickly as possible. Surplus credits (collected by overshooting the emission reducing target) can be sold in the global market. One credit is equivalent to one tonne of CO_2 emission reduced. Carbon Credit (CC) is available for companies engaged in developing renewable energy projects that

offset the use of fossil fields. Developed countries have to spend nearly $25 billion which will be ultimately spent by developing countries. In countries like *India,* GHG emission is much below the target fixed by Kyoto Protocol and so, they are excluded from reduction of GHG emission. On the contrary, they are entitled to sell surplus credits to developed countries. It is here that trading takes place. Foreign companies, who cannot fulfill the protocol norms, can buy the surplus credit from companies in other countries through trading. Thus, the stage is set for Credit Emission Reduction (CER) trade to flourish. India is considered as the *largest* beneficiary claming about 31 per cent of the total world carbon trade through the Clean Development Mechanism (CDM).

The trading takes place on two stock exchanges, the Chicago Climate Exchange and the European Climate Exchange. CC trading can also take place in the open market as well. European countries and Japan are the major buyers of carbon credit. Under the Kyoto Protocol, global warming potential (GWP) is an *index* that allows for the comparison of greenhouse gases with each other in the context of the relative potential to contribute to global warming. For trading purposes, one credit is considered equivalent to one tonne of CO_2 emission reduced.

Getting carbon credits certified for Kyoto is a rather lengthy and complex process. There are four stages of CDM approval. First stage is at the domestic level where the project gets approved by National CDM Authority (NCM). After NCM's approval the project is sent to the United Nations Framework Convention on Climate Changes. After this the executive board of UNFCCC reviews the project. The project gets evaluated on every front and is then registered under UN FCCC only if it meets all the norms. Thereafter, certification is done for the reduction in emission and credits are issued.

CARRY TRADE

Borrowing in one currency and investing in another is termed as carry trade. In recent times (upto November 2007) trillions of dollars have been borrowed in low-cost 'Yen' for deployment across money markets, stock markets, and even real estate markets across the globe and a part of the money flowed into India, too.

In recent months, Japan has been the best market for 'carry trades' because of a weak Yen and a cost of borrowing that is almost 'zero'; in seven years since 1999, and after two hikes by the Bank of Japan, the interest rate is 0.5 per cent. The money thus borrowed is usually invested in the respective currencies in markets where the interest rate is higher, or in equities. Preferred destinations include the USA, N. Zealand, and Australia for debt investments, and emerging markets such as India for equity investment.

CASH COW

A profitable business or firm (may belong to either public or private sector) which gives regular cash flow to the owner (this happens either due to regular demand of the popular goods produced by the firm or the compulsions of the consumer to buy the products). As for example the antiseptic lotion

‘Dettol’ is a cash cow for Reckitt and Colman in the private sector and LPG is a cash cow for the manufacturing and marketing government companies (provided there is no subsidy on LPG).

CAVEAT EMPTOR

A Latin phrase which means *‘let the buyer beware’*. Simply put, it means that the supplier has no legal obligation to inform buyers about any defects in his goods or services; the onus is on the buyer to himself determine the level of satisfaction out of the products.

CETERIS PARIBUS

A Latin phrase which means *‘other things being equal’*. The phrase is used by economists to cover their forecastings.

CHINESE WALL

The segregation of the different activities of a financial institution (such as jobbing, stockbroking, fund management, etc.) in order to protect clients’ interest.

CIRCUIT LIMIT

A limit of regular fall in share indices of Stock Exchanges around the world after which the exchange are closed for further trading. For example, circuit limit decided for the BSE (Bombay Stock Exchange) has been fixed at 10 per cent. The time there is a continuous fall in the BSE Sensex and it reaches 10 per cent, the exchange is closed to further trading.

Such a limit/provision prevents the share market from crashing down.

CLASSICAL ECONOMICS

A school of thought in economics based on the ideas of Smith, Ricardo, Mill, etc. The school dominated the economic thinking of the world until about 1870, when the *‘marginalist revolution’* took place.

CLEAN COAL

Underground coal gasification and liquefaction which converts coal into liquid and gaseous fuel alternatives is a recognised ‘clean coal’ technology–handy in extraction of energy from coal seams

which connot be mined through conventional methods.

CLOSED SHOP

The requirement that all employees of a given firm be members of a specified trade union. It is a method of restricting labour supply and maintaining high wages applied by a powerful trade union.

COLLECTIVE PRODUCTS

A product which can only be supplied to a group. Many goods and services provided by the governments fall in this category–national defence, police administration, etc.

COMMODITIES TRANSACTION TAX

[See Chapter 17, *Tax Structure in India*]

COMMODITY MONEY

Products being used as the means of payment as in the traditional barter system. Such practices take place generally when the confidence in money has fell down (as for example in the situations of high inflation and high depreciation).

COMMUNITISATION

A method of privatising public service delivery without going for the tendering process. It is done by transfering powers including financial powers to the user community who will take up the job of revenue collection along with an effective and more practical governance of the service delivery. This model is bereft of profit motive and so, more transparent.

Service delivery in communitised elementary schools and health service institutions has improved considerably and power tariff collection has risen by 100 per cent since the reform began in 2002 in Nagaland–Secretary, Union Ministry of Steel Raghaw Sharan Pandey who did it in Nagaland as its Chief Secretary.

COMPARATIVE ADVANTAGE

It is about identifying activities that an individual, a firm or a country can do most efficiently, being together.

The idea, usually credited to David Ricardo, underpins the case of free trade. It suggests that countries can gain from trading with each other even if one among them is more efficient (i.e., it has an *absolute advantage*) in every kind of economic activity.

CONSOLS

This is the abbreviated form of *consolidated stock.* The government bonds which have no maturity and thus have an indefinite life–are tradable on the floors of the stock exchanges.

CONSORTIUM

An *ad hoc* grouping of firms, governments, etc. brought together to undertake a particular project by pooling their resources and skills for major construction projects, loans, etc.

CONSUMER DURABLES

Consumer goods that are consumed over relatively long periods of time rather than immediately (opposite to the *consumer non-durables*) such as cars, houses, refrigerators, etc.

CONSUMER NON-DURABLES

Consumer goods which yield up all their satisfaction/utility at the time of consumption (Opposite to the *consumer durables*)–examples are cheese, pickles, jam, etc.

CONSPICUOUS CONSUMPTION

Consumption for the purpose of showing off ostentatiousness but not for the utility aspect –for example, the use of diamond-studded sandals, watches, pens, etc.

CONTAGION

A situation or an effect of economic problems in one economy spreading to another also known as the *domino effect*.

CONTRARIAN

A person following an investment strategy (specially in share market) just opposite to the general investors in a given period. For example, when a share is generally being sold by the investors, a contrarion keeps on buying them– the logic is that due to selling pressure the price will fall below the intrinsic value of the share and there is a prospect of future profit out of the share.

CORE INVESTMENT COMPANIES (CICS)

A NBFC carrying on the business of acquisition of shares and securities which satisfied the conditions: it holds not less than 90 per cent of its Total Assets in this form; its investments in the equity shares in group companies constitutes not less than 60 per cent of its Total Assets; it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment; and it does not carry on any other financial activity except investment in bank deposits, money market instruments, government securities, loans to and investments in group companies.

CORPORATE SUSTAINIBILITY INDEX

The Bombay Stock Exchange (BSE) has proposed to come out with a corporate sustainability index (CSI) – a possible new stock exchange which will be created for developing *trust marks* to denote a corporate's sustainability achievements. This will be the first such index in Asia.

CORRECTION

A term usually used in stock market which shows a reversals of share prices in reaction to an excessive rise or fall of the past.

CREATIVE DESTRUCTION

The process by which an innovative entrepreneur takes risks and introduces new technologies to stimulate economic activity, replacing old technologies is known as 'creative destruction'. As per *Schumpeter, Joseph A.* (1883–1950), creative destruction is the key to economic growth. But due to irregularity in such innovations, business cycle is followed by both collapse and crisis (J. A. Schumpeter, *Capitalism, Socialism and Democracy,* 1942).

CRONY CAPITALISM

An approach of doing business when the firms look after themselves by looking after their own people (i.e., families and friends). Used in negative sense.

CROSS SUBSIDY

The process of giving subsidy to one sub-area and fulfilling it through the profits from the other sub-area. As for example, in India Kerosene oil is cross-subsidised against Petrol and aviation fuel.

CROWDING-OUT EFFECT

A concept of public finance which means an increase in the government expenditure which has an effect of reducing the private sector expenditure.

CSR

The concept of corporate social responsibility (CSR) is fast gaining popularity among the corporate sector of the world. As per the experts, the CSR is qualitatively different from the traditional concept of passive philanthropy by the corporate houses. Basically, the CSR acknowledges the *debt* that the corporates owe to the community within which they operate. It defines the corporates' partnership with social action groups (i.e., the NGOs) in providing financial and other resources to support development plans, especially among disadvantaged communities. There is stress on long-term sustainability of business and environment and the distribution of well-being.

DEBENTURE

An instrument of raising long-term loan by companies, having a maturity period bearing an interest (*coupon rate*). Theoretically they may be secured or unsecured by assets such as land and buildings of the issuing company (known as *collateral*).

Debenture holders are provided with a prior claim on the earnings (by interest) and assets of the company in the situation of liquidation of the company over the *preference* and *equity shareholders* of the company.

DEBT RECOVERY TRIBUNAL (DRT)

Banks and financial institutions have often faced a tough time in recovering loans, on which the borrowers have defaulted. To expedite the recovery process, the Committee on the Financial System, headed by *Mr. Narasimham* considered the setting up of special tribunals, with special adjudicator powers. This was felt to be necessary to carry through financial sector reforms. Since there is an immense overload on the Indian legal system at present, recovery of many unpaid debts, due to banks or financial institutions, are held up, indefinitely. This affects the balance sheets of the banks as the amounts involved are very large.

It was thought that an independent forum was needed to deal with debts of these types. Thus, in *1993* the *Recovery of Debts Due to Banks and Financial Institutions Act'* was passed. The Act, however, imposes a limitation and states that only those debts which are in excess of Rs. 10 lakhs (or upto Rs. 1 lakh, where the Central government specified certain types of debts) would come under its purview.

The tribunals are set up by the Central government. The government also specified the areas within which such tribunals will have jurisdiction. A DRT consists of the Presiding Officer to be appointed by notification by the Central government. The government may also specify that the presiding officer of one tribunal may takeover the functions of the presiding officer of another tribunal. A person has to be at least a district judge to become a presiding officer of a Tribunal.

The very first step involved in the recovery process is to make an application to the Tribunal under Section 19 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993. Every bank and financial institution, which stands to recover loans and other debts, shall initiate the procedure by first forwarding an application to the Tribunal within the local limits of whose jurisdiction the defaulter company is located. After the financial institution has filled an application before the Tribunal, and if there are other banks whose loan to the same company has become bad, the latter can join the recovery suit.

DEBT SWAP SCHEME

In 2003, the Government of India announced a scheme to replace the relatively high cost debt of states with lower cost borrowings, taking advantage of falling interest rates. The scheme envisages states pre-paying that portion of their outstanding debt to the Centre on which the interest rate is 13 per cent and more, contracted during the mid-1990s when general interest rates were high.

Of a total stock of ‘2,44,000 crore of outstanding Plan loans, ‘1,00,000 crore worth of loans bear a coupon rate of 13 per cent and above. Servicing these loans is a major burden for states, many of which are undergoing fiscal stress. These loans from the Centre would be pre-paid using fresh, lower cost debt, which consists of both the small savings lent to the states by the National Small Savings Fund and additional market borrowings. As a result, while the total debt of the states would remain unchanged, the cost of servicing the loans would come down. This is the fiscal benefit to the states.

All collections from small savings, which include post office deposits, Kisan Vikas Patras, National Savings Certificates, and the Public Provident Fund (PPF), flow to the public account. After adjusting for repayments to the depositors of these small savings instruments, the entire net collections are lent to the states. Of the amount apportioned to each state based on the collection in the respective states, 70 per cent is made available as cash transfer, while the remaining 30 per cent is used for repaying the high cost loans of 13 per cent and above.

Apart from this, states are also now allowed to use additional market borrowings at an average interest rate of less than 6.5 per cent to retire high cost debt.

In simple language, what this means is that while the small savings deposits except for the PPF have a maturity of five to six years, the repayment of loans given to states against small savings is over a period of 25 years. If interest rates were to rise over the medium to long term, this could obviously create a problem for the centre, since the cost of its borrowings would be going up, while the return

on its existing loans to the states would remain locked. It is to take care of this risk that the higher spreads is needed.

DECOUPLING THEORY

Decoupling theory holds that Asian economies, especially emerging ones, no longer depend on the United States economy for growth, leaving them *insulated* from a severe slowdown there, even recession – looked true for some time as Asian stocks rose while socks in the US fell - however, as fears of recession mounted in the US, stocks declined heavily. Looking this happen in late 2008 the decoupling theory regarding the Asian as well as the EU economies have now lost ground. But still the emerging economies are able to have higher growth rates and exports in comparision to the US – that is why the theory is still debated by the experts.

DEINDUSTRIALISATION

Sustained decrease in the share of the secondary sector in the total output (GDP) of an economy.

DEMAT ACCOUNT

It is a way of holding securities in electronic or dematerialised form. Demat form of shares can be traded online. As such, the transactions are concluded much faster, which prevents theft, misuse, forging of original shares certificates or other documents, and allows an investor to buy or sell shares in any quantity. Demat account allows for faster refund of money in case application is not accepted. Demat accounts are offered by banks, and the dematerialised stock is held by the depository (National Securities Depository Ltd.–[NSDL] or Central Securities Depository Ltd.–[CSDL]). The investor needs to fill up the requisite forms, submit the documents and pay the applicable charges in order to have the demat account opened.

DEMERGER

The breaking-up of a company into more separate companies. Such companies are usually formed through mergers.

DERIVATIVES

The financial assets that "derive" their value from other assets, such as shares, debentures, bonds, securities, etc.

DIIS

Domestic Investment Institution (DIIs) are the financial institutions of Indian origin investing in India is different derivatives such as share, securities, corporate bounds, etc. They may be public/govt. owned or privately owned – mutual funds, pension funds and insurance (life) companies are the major ones in India.

DIRECT COST

The direct material and labour cost of a product–proportionally varies with the total output.

DIRECT INVESTMENT

The expenditure on physical assets (i.e., plant, machinery, etc.).

DIRTY FLOAT

A term of foreign exchange managment when a country manipulates its exchange rate under the floating currency system to take leverage in its external transactions.

DISCOUNT HOUSE

A financial institution specialising in buying and selling of short-term (i.e., less than one year) instruments of the money market.

DISGORGEMENT

Disgorgement is a common term in developed markets across the world, though for most market participants in India it is a new thing. Disgorgement means repayment of illegal gains by wrongdoers. Funds that were received through illegal or unethical business transactions are 'disgorged', or paid back, with interest to those affected by the action. It is for the first time in India that the capital markets regulator, SEBI has passed this order of disgorgement; internationally it is the civil courts that have this mandate along with the markets regulator.

Disgorgement is a 'remedial' civil action, rather than a 'punitive' civil action. In the US, individuals or companies that violate Securities and Exchange Commission regulations are typically required to pay both civil money penalties and disgorgement. Civil money penalties are punitive, while disgorgement is about paying back profits made from those actions that violated securities regulations.

Interestingly, disgorgement payments are not only demanded of those who violate securities regulations. In the US, anyone profiting from illegal or unethical activities may be required to disgorge their profits. The money disgorged from the violating parties is used to create a ‘Fair Fund’– fund for the benefit of investors who were harmed by the violation.

DISMANTLING OF TEXTILE QUOTA

Until December 31, 2004, global textile trade was largely regulated by the quota system. A textile exporting country (for example, India) could not export a particular textile item to an importing country (say, the US) beyond a fixed quantity, determined bilaterally. The phase-out of textile quota has removed the non-tariff barrier. The move is expected to drive outsourcing of textiles and apparel manufacturing to low-cost destinations. India is considered the *second largest* beneficiary of quota dismantling after China. It has advantages of having an integrated textile industry right from fibre to fashion. According to government projections, India’s textile exports is expected to touch $50 billion mark by 2010.

DISSAVING

The situation of higher current consumption over current disposable income by the households–the difference is met by withdrawals from the past savings (*i.e., decrease in saving*).

DOMINO EFFECT

An economic situation in which one economic event causes a series of similar events to happen one after the other. For example, experts believe that the falling of share indices around the world in early-2008 was a domino effect of the sub-prime crisis faced by the US economy. A similar case is cited from the mid-1996 when all major stock markets crashed around the world due to the domino effect emanating from the South East Asian currency crisis.

DOW-JONES INDEX

The US share price index which monitors and records the share price movements of all compaines listed on the New York Stock Exchange (*with the exception of high-tech companies which are listed on the NASDAQ stock exchange*). India has its equivalent in the BSE *Sensex*.

DRUG PRICE CONTROL

Drug price control, as the term suggests, means a mechanism or a policy that ensures that *essential*

and *life-saving* medicines are available at reasonable prices. Control over cost of medicines to the consumer exists in one form or the other in most countries. Government's control over drug pricing in India had begun in the wake of the Sino-Indian war, but a structured price control mechanism was only first instituted in 1979 with the issuance of the first Drug Price Control Order (DPCO).

The Drugs Price Control Order, 1995 is an order issued by the Government of India under Section 3 of the Essential Commodities Act, 1955. The Order provides the list of price-controlled drugs, procedures for fixation of prices of drugs, method of implementation of prices fixed by government and penalties for contravention of provisions among other things. For the purpose of implementing provisions of DPCO, powers of the government have been vested in the National Pharmaceutical Pricing Authority. As of now, 74 bulk drugs are under price control and there is no price control on 70 to 75 per cent of the retail pharma market.

Drugs and formulation have been subjected to price control for more than three decades now and the industry's stand is that when price control has been abolished in a large number of industries, it is unfair to stifle the pharmaceutical industry with rigorous price control. While the government has expressed that it wants to provide a stable policy environment to the pharmaceutical industry, it has also said that it will ensure the availability of essential and life-saving drugs at reasonable prices to the public.

DUMPING

Exporting a good at a price lower than its price in the domestic market. To neutralise the effects of dumping the importing country may impose a *surcharge* on such imports which is known as the *anti-dumping duty*.

DUTCH DISEASE

When an increase in one form of net exports drives up a country's exchange rate, it is called the Dutch Disease. Such instances make other exports non-competitive in the world market and impairs the ability of domestic products to compete with imports.

The term originated from the supposed effect of natural gas discoveries on the Netherlands economy.

DUTY DRAWBACK SCHEME

The Duty Drawback Scheme (DDS) is provided by the Government of India as a part of export incentives to make exports competitive. Exporters get refund of the central excise (censat) and custom duties on the inputs they use in manufacturing the exportables. Those who are covered by the Duty Entitlement Passbook Scheme (DEPS) are not covered by it. The rates are announced from time to time.

DUTY ENTITLEMENT PASSBOOK SCHEME

The Duty Entitlement Passbook Scheme (DEPS) is an export incentive scheme of the GoI under which exporters get credit (pre-determined by the Direcor General of Foreign Trade) on the export value which they use in future imports thus neutralising all the taxes. No cash is given (unlike the Duty Drawback Scheme). It has been abolished by the GoI w.e.f. October 1, 2011 after using it for 14 years – the WTO provisions do not allow member countries to carry such schemes.

e-BUSINESS

Using computers and the Internet to link both the *internal* operations (i.e., transactions and communications between the various departments/divisions of the business firm) and its *external* operations (i.e., all its dealings with the suppliers, customers, etc.).

e-COMMERCE

Method of buying and selling goods and services over the Internet – a kind of direct marketing i.e. without the help of any middle arrangement of sales.

ECONOMIES OF SCALE

The long-run reduction in average/unit cost that occurs as the scale of the firm's output increases. The opposite situation is known as *diseconomiess of scale.*

ECONOMIES OF SCOPE

The long-run reduction in average/unit cost that occurs as the scope (diversification) of the firm's activities increase.

EDGEWORTH BOX

A concept for the purpose of analysing the possible relationships between two individuals or countries. It is done using indifference curve.

The concept was developed by Francis Ysidro Edgeworth (1845–1926) who is also credited for analytical tools of *indifference curves* and *contract curves.*

EFFECTIVE REVENUE DEFICIT

[See Chapter 18, *Public Finance in India*]

ENGEL'S LAW

The law which says that people generally spend a smaller part of their budget on food as their income rises. The idea was suggested by Ernst Engel, a Russian statistician in 1857.

ENVIRONMENTAL ACCOUNTING

The method of accounting which includes the ecological and environmental damages done by the economic activities in monetary terms. Integrated environment and economic (green) accounting attempts at accounting for both socioeconomic performance and its environmental effects and integrates environmental concerns into mainstream economic planning and policies. The *green GDP* of an economy is measured by the same method–experimented in Costa Rica, Mexico, Netherlands, Norway, and Papua New Guinea, among others. Indicative estimates suggest that conventionally measured GDP may exceed GDP adjusted for natural resources depletion and environmental degradation by a range between 1.5 per cent and 10 per cent.

ENVIRONMENTAL AUDIT

Assessment of the environmental impact of a firm/public body through its activities. This is done with an objective to reduce or eliminate the pollution aspect.

ENVIRONMENTAL TAXES

As against the Command and Control approach to managing environment, the Economic or Market Based Instruments (MBIs) approach sends economic signals to the polluters to modify their behaviour. The MBIs used for environmental taxes include pollution charges (emission/affluent & tax/pollution tax), marketable permits, deposit refund system, input taxes/product charges, differential tax rates, user administrative changes and subsidies for pollution abatement, which may be based on both price and quality. India has been already collecting taxes on *water* and *air* via theWater Act and the Air Act. Due to its experience India is among the chief participant in devising the MBIs in the world.

EQUITY LINKED SAVING SCHEME

Equity linked savings schemes (ELSS) are open-ended, diversified equity schemes offered by mutual funds. They offer tax benefits under the new section 80C introduced in the Finance Bill 2005–06. Till the fiscal year 2004–05, maximum investment of Rs. 10,000 was eligible for tax benefits under the erstwhile Section 88 of the I-Tax Act. Effective April 1, 2005, the investment is included in the overall '1,00,000 limit set by the new Budget.

Besides offering the tax benefits, the scheme invests in shares of frontline companies and offers long-term capital appreciation. This means unlike a guaranteed return by assured return schemes like Public Provident Fund or National Savings Certificate, the investor gets the benefit of the upside (if any) in the equity markets.

Unlike other mutual fund schemes, there is a three-year lock in period for investments made in these schemes. Investors planning to build wealth over the long-term and save on tax can use these schemes.

Returns in these schemes are linked to the fortunes of the stock market. It falls in the high risk and high return category. Over the past one year, these schemes have clocked a return of over 30 per cent. The BSE 200 index rose 7 per cent over the past one year. This indicates that these funds outperformed the broader market. However, past performance is not a guarantee for future growth. Investors should assess their respective risk appetites before investing.

EQUITY SHARE

A security issued by a company to those who contributed capital in its formation shows ownership in the company. The other terms for it are 'stock' or 'common stock'.

Such shares might be issued via public issue, bonus shares, convertible debentures, etc. and may be traded on the stock exchanges.

Such shareholders have a claim on the earnings and assets of the company after all the claims have been paid for. This is why such shareholders are also known as the *residual owners.*

ESCROW ACCOUNT

In simple terms, an 'escrow account' is a *third party account*. It is a separate bank account to hold money which belongs to others and where the money parked will be released only under fulfilment of certain conditions of a contract. The term ***escrow*** is derived from the French term 'escroue' meaning a scrap of paper or roll of parchment, an indicator of the deed that was held by a third party till a transaction is completed.

An escrow account is an *arrangement for safeguarding* the 'seller' against its 'buyer' from the payment risk for the goods or services sold by the former to the latter. This is done by removing the control over cash flows from the hands of the buyer to an independent agent. The independent agent, i.e, the holder of the escrow account would ensure that the appropriation of cash flows is as per the agreed terms and conditions between the transacting parties.

Escrow account has become the standard in various transactions and business deals. In India escrow

account is widely used in public private partnership projects in infrastructure. RBI has also permitted Banks (Authorised Dealer Category I) to open escrow accounts on behalf of Non-Resident corporates for acquisition / transfer of shares / convertible shares of an Indian company.

ESOPS

Employee Stock Option Plans (ESOPs) is a provision under which a foreign company (i.e., MNC) offers shares to its employees overseas. Till February 2005 in the case of local firms, an MNC needed a permission from the RBI before allotting ESOPs, but since then, it does not need any permission provided the company has a minimum of 15 per cent holding in the Indian arm.

EXPLODING ARMS

A term associated with the mortgage business which became popular after the subprime crisis hit the US financial system in mid-2007. Exploding arms are mortgages with initial low, fixed interest rates which escalate to a high floating rate after a period of two to three years.

EXTERNALITIES

Factors that are not included in the gross income of the economy but have an effect on human welfare. They may be *positive* or *negative*–training personnel is an example of the former while pollution falls in the latter.

FCCB

Foreign Currency Convertible Bond, (FCCB) is an unsecured instrument to raise long-term loan in foreign currency by an Indian company which converts into shares of the company on a predetermined rate. It is counted as the part of external debt. It is a safer route to raise foreign currency requirements of a company.

FEDERAL FUND RATE

The federal fund rate (also popular as *Fed Fund Rate* or *Fed Rate*) is the rate of interest banks charge each other on overnight loans in the USA. The rate is fixed by the US central bank Federal Reserve. This is equivalent to the *Repo rate* of India which is fixed by the RBI.

The Federal Reserve cut the Fed Rate by 0.75 per cent on January 22, 2008 (now the rate stands at 3.5 per cent) to ward off the increased fear of a recession in the US economy which has also generated worldwide free fall of share indices since mid-January 2008. In wake of the sub-prime real

estate crisis wrecking havoc on the US economy, the Fed Rate has been cut time and again to counter the possible future recession.

FIDUCIARY ISSUE

Issuance of currency by the government not matched by gold securities, also known as *fiat money*.

FINANCIAL CLOSURE

Financial closure is defined as a stage when all the conditions of a financing agreement are fulfilled prior to the initial availability of funds. It is attained when all the tie ups with banks or financial institutions for funds are made and all the conditions precedent to initial drawing of debt is satisfied.

In a Public Private Partnership (PPP) project, financial closure indicates the commencement of the *Concession Period* – the date on which financial closure is achieved is the appointed date which is deemed to be the date of commencement of concession period. In order to give a uniform interpretation to the term, the RBI has provided a definition – for 'Greenfield' projects, financial closure is *"a legally binding commitment of equity holders and debt financiers to provide or mobilise funding for the project. Such funding must account for a significant part of the project cost which should not be less than 90 per cent of the total project cost securing the construction of the facility"*.

FINANCIAL STABILITY BOARD (FSB)

The Financial Stability Forum (FSF) was established by the G7 finance ministers and central bank governors in 1999 to promote international financial stability through enhanced information exchange and international cooperation in financial market supervision and surveillance. It decided at its plenary meeting in London on March 2009 to broaden its membership by inviting the new members from the G20 countries, namely, Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey. the FSF was relaunched as the Financial Stability Board (FSB) on April 2, 2009, in order to mark a change and convey that the FSF in future would play a more prominent role in this direction.

FISCAL DRAG

The restraining effect of the progressive taxation economies feel on their expansion–fall in the total demand in the economy due to people moving from lower to higher tax brackets and the government tax receipts go on increasing. To neutralise this negative impact, governments usually increase personal tax allowances.

FISCAL NEUTRALITY

A stance in policy making by governments when the net effect of taxation and public spending is neutral–neither encouraging nor discouraging the demand. As for example, a *balanced budget* is the same attempt of fiscal policy when the total tax revenue equals the total public expenditure.

FISHER EFFECT

A concept developed by *Irving Fisher* (1867–1947) which shows relationship between inflation and the interest rate, expressed by an equation popular as the *fisher equation* i.e., the nominal interest rate on a loan is the sum of the real interest rate and the rate of inflation expected over the duration of the loan:

$$\mathbf{R = r + F;}$$

where R = nominal interest rate, r = real interest rate and F = rate of annual inflation.

The concept suggests a direct relationship between inflation and nominal interest rates – changes in inflation rates leads to matching changes in nominal interest rates.

The Fisher effect can be seen each time one goes to the bank; the interest rate an investor has on a savings account is really the nominal interest rate. For example, if the nominal interest rate on a savings account is 4 per cent and the expected rate of inflation is 3 per cent, then money in the savings account is really growing at 1 per cent. The smaller the real interest rate the longer it will take for savings deposits to grow substantially when observed from a purchasing power perspective.

FLAG OF CONVENIENCE

Shipping rights in oceans and seas are governed by international treaties. Flag of convenience is a grant of a shipping 'flag' by a member of these treaties to a non-member nation establishing the legality of shipping to the latter (*usually used for illegal activities*).

FORCED SAVING

The enforced reduction of consumption in an economy. It may take place directly when the government increases taxes or indirectly as a consequence of higher inflation–a tool usually utilised by the developing countries to generate extra funds for investment. Also known as *involuntary saving*.

FoB

This is the abbreviation of 'free-on-board'–when in the balance of payment accounting, only the basic

prices of exports and imports of goods (including loading costs) are counted. It does not count the 'cost-insurance-freigth' (CiF) charges incurred in transporting the goods from one to another country.

FORM OF A LIFE INSURANCE FIRM

A life insurance company can be a joint-stock or mutual entity. If joint-stock, it has to have some capital, to begin with. A mutual fund company need not have any. Prudential, the second largest life insurance company in the UK was a mutual fund company till a few years ago and had no capital. Standard Life, another big company, was a mutual company till a few months ago. If such big companies could function without any capital till recently, there is no reason why LIC cannot.

The policyholders are the owners of a mutual company and the entire profit goes to them. A significant proportion of the profit goes to shareholders in the case of joint-stock companies. The LIC, owned fully by the Government, is effectively a mutual fund company and it is not surprising, therefore, that pressure is being mounted to privatise it, so that a chosen few could not corner its huge profits.

FORWARD CONTRACT

A transaction contract of commodity on an agreed price which binds the seller and buyer both to pay and deliver the commodity on a future date. The price agreed upon is known as *forward* rate.

One must not confuse this with the term 'future contract' as in it, the term of the contract cannot be decided by the mutual needs of the parties involved (which is possible in a 'forward contract').

FORWARD TRADING

A trading system in certain shares (as allowed by the SEBI in India) in which buyers and sellers are allowed to postpone/defer payment and delivery respectively after paying some charges. If the buyer wants deferment, it is known as *badla* (an Indian term for *contango*) and if the seller goes for deferment of delivery of shares, it is known as *undha badla* (in India, elsewhere it is known as *backwardation*).

FRACTIONAL BANKING

A system of banking in which banks maintain a minimum reserve asset ratio in order to maintain adequate liquidity to meet the customer's cash demands in its everyday business (*the SLR in India is such a provision,*).

FREE GOODS

The goods which are in abundance (*as air and water*) and are not considered as scarce economic goods. As such goods have *zero supply price* and they will be used in large volumes resulting into rising environmental pollution (point should be noted that today air and water may not be considered as the typical free goods, at least the 'pure air' and 'pure water').

FREE TRADE

The international trade among an agreed-upon group of countries without any barriers (such as tariffs, quotas, forex controls, etc.), promoted with the objective of securing international specialisation and an edge in their foreign trade.

FREE PORT

A port that is designated as such is the one where imports are allowed without any duty, provided they are re-exported (i.e., *entrepot*). If the same is correct in the case of an area, it is known as the *free trade zone.*

FRINGE BENEFIT TAX

The fringe benefit tax is an additional tax imposed by the Union government in order to bring under the tax net fringe benefits received by the employees from his employer.

The various categories of employers are defined under the new provision. This includes an individual or a Hindu Undivided Family engaged in a business or profession, a company, a firm, an association of persons, a body of individuals, a local authority and every artificial juridical person. The key point is that even individuals running small businesses are covered and thus would include someone who even employs a single person.

It is very important to note the exact definition of fringe benefits because only those items that get covered here would be included for the purpose of taxation. It means any privilege, service, facility or amenity, directly or indirectly provided by an employer to his employees. It also includes such facilities provided to former employees. Any reimbursement made either directly or indirectly to the employer will also be considered as a fringe benefit. Travelling ticket provided by the employer to the employees and his family members would be a fringe benefit. Even an amount, which is a contribution by the employer to an approved superannuating fund would be called a fringe benefit.

This is not the end of the matter for there is a category called *deemed* fringe benefits which will suffer the same tax effect. These are benefits that are deemed to have been provided if the employer has in the course of business or profession incurred any expenses on or made any payment for a whole host of fringe benefits. These include entertainment, festival celebration, gifts, use of club facilities,

provision of hospitality facilities, maintenance of any accommodation in the nature of a guest house, conference, employee welfare, use of health club, sports and similar facilities, sales promotion including publicity; conveyance tour and travel including foreign travel, hotel, boarding and lodging, repair, running and maintenance of motorcars, repair running and maintenance of aircrafts, consumption of fuel other than imnndustrial fuel, use of telephone, scholarship to the children of the employees.

Tax calculation has to follow a specific procedure. First one has to check whether the benefit falls under the head of fringe benefits. Once this is determined a certain percentage of the expense is then taken as the value on which the tax is to be levied. These percentage has been listed in the budget. For example, the amount to be considered is 50 per cent of the expenses for entertainment and 20 per cent for conveyance, tour and travel. On this a rate of 30 per cent (i.e., 30 per cent of 50 per cent in case of entertainment) is applied as a tax.

GALLUP POLL

A method of survey in which a representative sampling of public opinion or public awareness concerning a certain subject/issue is done and on this basis a conclusion is drawn.

The credit of developing this research methodology goes to *George H. Gallup* (1901–84), a US journalist and statistian who in 1935 did set up the *American Institute of Public Opinion.* Through his efforts the method developed between the period 1935–40. In the coming times, the poll technique was immensely used by business houses for their market research and the psephologists for election forecasting, around the world.

GAME THEORY

The analysis of situations involving two or more interacting decision makers (that may be individuals, competing firms, countries, etc.) who have conflicting objectives. It is a technique which uses logical deduction to explore the consequences of various strategies that might be adopted by game players having competing interests.

Game theory is a branch of *Applied Mathematics* that studies strategic interactions between agents–where the agents try maximising their pay off. It gives *formal modeling approach* to social situations in which decision makers interact with other agents. The theory generalises maximisation approaches developed to analyse markets such as supply and demand model.

The field dates back from the 1944 classic *Theory of Games and Economic Behaviour* by John von Neumann and Oskar Morgentern (Princeton University Press, N. Jersy, 1944 & 2004; 60th Anniversary Ed.). Neumann was a mathematician and Morgenstern an economist and this book was based on the former's prior research published in 1928 on the *Theory of Parlour Games* (in German).

The theory has found significant applications in many areas outside economics as usually construed, including formulations of nuclear strategies, ethics, political science, and evolutionary theory.

GDRS

While ADRs are denominated in dollars and traded on US National Stock Exchanges, GDRs can be denominated either in dollars or Euros and are commonly listed on European Stock Exchanges. Investors can cash in on the difference in price between local and foreign markets. Some time back ADRs and GDRs were *fungible* one way i.e. foreign investors could convert their ADRs/GDRs into underlying shares and sell them in the local market. However, they were not permitted to reconvert shares bought on the local exchange into ADRs/GDRs. In 2002, *two-way fungibility* was permitted. Under these rule reissuance of depositary receipts is permitted to the extent to which they have been redeemed into underlying shares and sold in the domestic market.

GIFFEN GOOD

The good for which the demand increases as its price increases, rather than falls (opposite to the *general theory of demand*)–named after Robert Giffen (1837–1910). It applies to the large proportion of the goods belonging to the household budget (as flour, rice, pulses, salt, onion, potato, etc. in India)–an increase in their prices produces a large *negative income effect* completely overcoming the normal substitution effect with, people buying more of the goods.

GINI COEFFICIENT

An inequality indicator in an economy. The coefficient varies from 'zero' to 'one'. A 'zero' Gini coefficient indicates a situation of perfect equality (i.e., every household earning the same level of income) while a 'one' signifies a situation of absolute inequality (i.e., a single household earning the entire income in an economy).

GOLDEN HANDSHAKE

A payment (usually generous) made by a company to its employees for quitting the job prior to their service.

GOLDEN HANDCUFF

A royalty/bonus payment by a company to its staff (usually top ranking) to keep them with the company or to save them from poaching by the other companies.

GOLDEN HELLO

A large sum paid by a company to attract a new staff to its fold.

GOLDEN RULE

A fiscal policy stance which suggests that over the economic cycle, government should borrow only to 'invest' and not to finance the 'current expenditure'. The attempts towards 'balanced budgeting', 'zero-based budgeting' developed under influence of this rule.

GOODHART'S LAW

The idea of Goodhart which suggests that attempts by a central bank (as RBI in India) to regulate the level of lending by banks imposing certain controls can be circumvented by the banks searching the alternatives out of the regulatory preview.

GO-GO FUND

The highly speculative mutual funds operating in the USA with the objective of earning high profits out of capital appreciation–adopt risky strategies for the purpose (investing in volatile unproven and small shares, etc.)–also called the *performance funds*.

GREATER FOOL THEORY

A theory evolved by the technical analysts of stocks/shares according to which some even buy overvalued stocks with the conviction that they will find a *greater fool* who will buy them at higher prices. This is also popular as *castle-in-the-air theory*.

GREENFIELD INVESTMENT

An investment by a firm in a new manufacturing plant, workshop, office, etc.

GREENFIELD LOCATION

An area consisting of unused or agricultural land (*i.e., 'greenfield'*) developed to set up new industrial plants.

GREEN REVOLUTION &

INSTITUTIONS

The support of institutions and the governments of the world did play a very vital role in the success of the Green Revolution all over the world.

The International Maize and Wheat Improvement Centre (CIMMYT), Mexico and the International Rice Research Institute (IRRI), Manila were the two institutions in strong partnership with national programmes which developed the miracle varieties of rice and wheat that fuelled the Green Revolution around the world.

The Consultative Group on International Agricultural Research (CGIAR), set up in 1971 (in Washington DC under the aegis of the World Bank) played a central role in Green Revolution, supporting the works of the CIMMYT and IRRI. Today, the 16 CGIAR support centres around the world generate new knowledge and farming technology for the agriculture sector. Its research products are "global public goods", freely available to all.

GREENSHOE OPTION

A term associated with the security/share market. This is a clause in the underwriting agreement of an initial public offer (IPO) by a company which allows to sell additional shares (usually 15 per cent) to the public if the demand for shares exceeds the expectation and the share trades above its offering price. It gets its name from the *Green Shoe* company which was the first company to be allowed such an option (in the USA, early 20th century). This is also known as *'over-allotment provision'*.

The company availing this option uses the proceeds (i.e. from the greenshoe option) to prevent any decline in market price of shares below the issue price in the post-listing period (in such cases the aforesaid company uses the money to purchase its own shares from the market–as demand increases, the market price of its shares picks up).

GRESHAM'S LAW

The economic idea that 'bad' money forces 'good' money out of circulation–named after Sir Thomas Gresham, an adviser to Queen Elizabeth I of England. This law does not apply to the economies where paper currencies are in circulation. The economies which circulate metallic coins (gold, silver, copper, etc.) of proportional intrinsic values face such situations when people start hoarding such coins.

GREENSPAN PUT

A financial market terminology named after the former chairman, of the US central bank, Federal Reserve, to mean the helpful way he responded to big declines in the stock market by delivering a cut in interest rates.

GREY MARKET

The 'unofficial' market of the newly issued shares before their formal listing and trading on the stock exchange.

GROWTH RECESSION

An expression coined by economists to describe an economy that is growing at such a slow pace that more jobs are being lost than are being added. The lack of job creation makes it 'feel' as if the economy is in a recession, even though the economy is still advancing. Many economists believe that between 2002 and 2003, the United States' economy was in a growth recession.

In fact, at several points over the past 25 years the US economy is said to have experienced a growth recession. That is, in spite of gains in real GDP, job growth was either non-existent or was being destroyed at a faster rate than new jobs were being added.

3G TECHNOLOGY

3G refers to the third generation of developments in wireless technology. It is a collective term for the new communication procedures, standards, and devices that will improve the speed and quality of services on mobiles. 3G-compatible handsets combine the functionality of a mobile phone with that of a PC and a personal organiser/PDA.

3G divides each call or transmission into little packets of data, marking each one with an individual code to show which connection it belongs to. This is a more efficient way of transmitting data, allowing 3G networks to deliver larger files, like pictures and video, at much faster speeds.

3G devices have greater transmission abilities, both in terms of speed and capacity, than 2G or 2.5G. The International Telecommunications Union (ITU) *defines* 3G as any device that can transmit and receive data at 144Kbps or more. In practice, 3G devices can transfer data at up to 384Kbps.

Besides phone calls, 3G allows fax transmissions, e-mails, including large attachments, while on the move. High-speed internet access allows web browsing and fast downloading of data files, software, image or music files. 3G can be used for video conferencing and some 3G handsets can also function as personal organisers, with electronic diaries, contact lists, and automatic reminders. Most 3G networks offer global roaming.

Japan is the *first* country which introduced 3G on a large commercial scale in 2005. 3G is now also in use in France, Germany, and Austria besides some other countries.

There is no single global 3G standard, but the principal technologies of 3G include:

(i) WCDMA, which has been chosen for 3G mobile phone systems in Europe, Asia, and the US. It first converts raw data into a narrow band digital radio signal and then attaches a marker to each data packet to identify it as belonging to a particular communication.

(ii) Customers who already use CDMA can upgrade to newer models. CDMA2000 IxEV-DO

provides always–on packet data connection like landline-based broadband, for mobile internet use.

(iii) EDGE is the technology that allows existing GSM networks to provide 3G services and allows GSM to transmit data at transmission speeds of up to 384Kpbs.

GSM operators offering EDGE-based services are already providing some 3G-like services including video on the move. 3G requires spectrum in specified bands and telecom regulator TRAI has identified 450 MHz, 800 MHZ, and 2.1 Ghz as 3G bands. 3G services will be launched in India only after the government announces its spectrum policy and allocates spectrum in the required bands. This is expected by the end of 2008. After that, it will take a minimum of three months for operators to rollout 3G services.

HEDGE FUNDS

These are basically mutual funds (MFs) which invest in various securities in order to contain or hedge risks. They are investment vehicles that take big bets on a wide range of assets and specialise in sophisticated techniques of investment. They are meant to perform well in falling as well as rising markets!

Run by former bankers or traditional investment managers by setting up their own funds, they make a lot of money by charging high fees typically 2 per cent management fees besides 20 per cent of the profits out of the investment. As they are unregulated in most of the economies (for example the USA, India, specially) and risky, they accept investments from wealthy and sophisticated investors.

Hedge funds made news in recent times as some of them were caught out by betting the wrong way on the market movements. Some of them also made huge losses by buying the complex packages of debt that contain many of the US mortgage loans which turned sour. It is believed that 33 per cent of stocks traded on the London Stock Exchange and 20 per cent on the New York Stock Exchange are managed by numerous hedge funds. In the case of India, it is believed that foreign investment in the Indian stocks (which accounted for almost 75 per cent of the total stocks by November 2007) has a heavy share of such funds–the Participatory Notes (PNs) route investment (i.e., 52 per cent of the total foreign investment in shares) is considered as hedge fund investment.

In recent years, there have been several high-profile hedge fund collapses. The Long -Term Capital Management (LTCM) of the US failing in 1998 had threatened the very stability of the US financial system–looking at the level in impact the regulators managed a bail out for it to prevent an imminent financial collapse. In 2006, the world saw the collapse of another hedge fund in the US, the *Amaranth* which lost $6.5 billion in a month in the natural gas market (The fund in place of a bail out was closed down by the regulators with the investors losing heavily.)

HERFINDAHL INDEX

This is a measure of the level of seller concentration in a market which takes into account the total number of firms and their relative share in the total market output. Also known as *Herfindahl-*

Hirschman Index.

HIDDEN PRICE REDUCTION

A quantitative or qualitative increase of a product by keeping the price unchanged. We see it taking place in the case of many goods in the market selling ‘20 per cent or 33 per cent extra’ at the same prices.

HIDDEN PRICE RISE

A quantitative or qualitative decrease in a product without changing the price.

HIDDEN TAX

Addition of an indirect tax into the price of a good or service without fully informing the consumer as, for example, the magnitude of the excise duty in tobacco and alcoholic products is so high that the taxes are added to the products directly.

HISTORIC COST

The original cost of purchasing an asset such as land, machine etc., which is shown in the balance sheet of a firm under this title with an adjustment for the replacement cost of the asset.

HOARDING

An act of unproductive retention of *money* or *goods*.

HOG CYCLES

The cycles of over and under production of goods. This takes place due to time lag in the production process–this happens in case of agricultural products specially.

IMPOSSIBLE TRINITY

This is a term to show the central bank’s dilemma in targeting for stable exchange rate, interest rate

and inflation while announcing the credit and monetary policy for the economy. As this task is not only challenging but also not possible, it is called as the ‘impossible trinity’.

INDIA’S SOVEREIGN RATING

Presently, India is rated by six international credit rating agencies, namely Standard and Poor’s (S&P), Moody’s Investor Services, FITCH, Dominion Bond Rating Service (DBRS), the Japanese Credit Rating Agency(JCRA), and the Rating and Investment Information Inc., Tokyo(R&I). Information flow to these credit rating agencies has been streamlined.

INDIFFERENCE CURVE

A curve on the graph showing the alternative combinations of two products, each giving the same utility/satisfaction.

INDUCED INVESTMENT

The part of investment (increase or decrease) which takes place due to a change in the level of national income.

IIFCL

The India Infrastructure Finance Company Ltd (IIFCL), a Government of India company set up in 2006 to promote public sector investments and public-private partnerships (PPPs) in all areas of infrastructure *except* the telecommunication.

INFERIOR PRODUCT

The good or service for which the income elasticity of demand is negative (i.e., as income rises, buyers go to purchase less of the product). For such products, a price cut results into lesser demands by the buyers.

INFLATION

For all types of inflation see the chapter with the same title.

INSIDER TRADING

A stock market terminology which means transactions of shares by the persons having access to confidential informations which are not yet public–such persons stand to gain financially out of this knowledge (the person might be an employee, director, etc. of the share issuing company or the merchant bank or the book runner to the issue, etc.). Such kind of trading in stocks is illegal all over the world.

INSOLVENCY

The situation when the liabilities of an individual or a firm to creditors exceeds its assets–inability to pay the liabilities from the assets. Also known as *bankruptcy*.

INVENTORY

The stocks of finished goods, goods under the production process and raw materials held by a firm.

INVISIBLE HAND

A term coined by Adam Smith (in his magnum opus *The Wealth of Nations, 1776*) to denote the way in which the market mechanism (i.e. the price system) coordinates the decisions of buyers and sellers without any outside conscious involvement. For him this maximises individual welfare.

IPO

An IPO or initial public offering refers to the issue of shares to the public by the promoters of a company for the first time. The shares may be made available to the investors at face value of the share or with a premium as per the perceived market value of the share by the promoters. The IPO can be in the form of a fixed price portion or book building portion. Some companies offer only demat form of shares, others offer both demat and physical shares.

The performance of an IPO depends on many factors such as the promoter's track record, experience in running the business, risk factors listed in the offer document, nature of industry, government policies associated with the industry performance of that sector in the previous years, and also any available forecasts for the industry for the near future.

I-S SCHEDULE

Here 'I-S' stands for 'investment saving'. This graphic schedule displays the combinations of levels of national income and interest rate where the equilibirium condition for the real economy (investment = savings) holds.

ISLAMIC BANKING

It is banking practiced as per the Islamic principle as prescribed in the *Shariah* known as *Fiqh al-Muamalat* (Islamic rules on transaction). The Islamic law prohibits interest on both loans and deposits. Interest is also called *riba* in Islamic discourse. The argument against interest is that money is not a good and profit should be earned on goods and services only not on control of money itself. But Islam does not deny that capital, as a factor of production deserves to be rewarded. It, however, allows the owners of capital a share in a surplus which is *uncertain*.

It operates on the principle of sharing both profits and risks by the borrower as well as the lender. As such the depositor cannot earn a fixed return in the form of interest as happens in conventional banking.

But the banks are permitted to offer incentives such as variable prizes or bonuses in cash or kind on these deposits.

The depositor, who in the conventional banking system is averse to risk is a provider of capital here and equally shares the risks of the bank which lends his funds.

Investment finance is offered by these banks through *Musharka* where a bank participates as a joint venture partner in a project and shares the profits and losses. Investment finance is also offered through *Mudabha* where the banks contribute the finance and the client provides expertise, management, and labour, and the profits are shared in a prearranged proportion while the loss is borne by the bank.

Trade finance is also offered through a number of ways. One way is through *mare up,* where the bank buys an item for a client and the client agrees to repay the bank the amount along with an agreed profit later on. Banks also finance on lines similar to *leasing, hire purchase,* and *sell and buyback*. *Consumer lending* is without any interest, but the bank covers expenses by levying a service charge. Besides, these banks offer a host of fee-based products like money transfer, bill collections, and foreign exchange trading where the bank's won money is not involved.

Islamic banks have come into being since the early 1970s. There are nearly 30 Islamic banks all over the world from Africa to Europe to Asia and Australia and are regulated even within the conventional banking system. The whole banking system in Iran has moved over to the Islamic system since the early 1980s and even Pakistan is Islamising its banking system.

Many of the European and American Banks are now offering Islamic banking products not only in muslim countries, but also in developed markets such as the United Kingdom. The concept is also catching up in countries like Malaysia and Dubai.

As per the Islamic experts, with growing indebtedness of many governments and with bulk of the borrowing going to servicing of the past debt and payment of huge interests, it could be an alternative to conventional banking as practiced in the rest of the world. Wherever it is practiced, *studies* have shown that the rate of return is often comparable and sometimes even higher than the interest rate

offered by conventional banks to depositors.

Though there is no full-fledged Islamic bank, there are many NBF intermediaries in Mumbai and Bangalore operating on Islamic principles. Besides, their presence in the form of co-operatives in various parts of the country has been there even before independence.

The Reserve Bank of India, which regulates the banking sector in India has recently appointed a committee headed by the Chief General Manager to look into the prospects of introducing certain Islamic products and banks in India. What is unique is that the products are structured according to norms prescribed in the *Shariah*.

In many countries, these banks do not have the power of issuing cheques. Besides, many banks which operate on a very small-scale, do not have adequate internal control system because of which their accounting is not very transparent and also inadequate information is provided to the regulator. Besides, wherever they co-exist with conventional banking, central bank control of bank interest rates is liable to be circumvented by shifts of funds to the Islamic banks.

ISOCOST LINE

A line on the two-axis graph which shows the combination of factor inputs that can be purchased for the same money.

ISOCOST CURVE

A curve on the graph showing the varying combinations of factors of production (i.e., labour, capital etc.) that can be used to produce a given quantity of a product with a given technology.

J-CURVE EFFECT

The tendency for a country's balance of payments deficit to initially deteriorate following a devaluation of its currency before moving into surplus.

JOBBER

An individual active on the floors of the stock exchanges who buys or sells stocks on his own account. A jobber's profit is known as *jobber's spread.* They are also known as *Taravniwalla* on the Bombay Stock Exchange (BSE).

JUNK BOND

An informal term denoting the financial securities issued by a company/bidder as a means of

borrowing to finance a takeover bid. Such securities generally include high-risk, high-interst loans, that is why the term ‘junk’ is used. It is also known as *mezzanine debt.*

KERB DEALINGS

All the transactions taking place outside the stock exchanges.

KLEPTOCRACY

A government which is corrupt and thieving – the politicians and bureaucrats in charge using the powers of the state to earn personal benefits/profits. Russia after the disintegration is condsiered to be a clear-cut example when Mafia-friendly government allotted valuable shares of the government companies when they were privatised.

KONDRATIEFF WAVE

A business cycle of 50 years, named after the Russian economist Nikolai Kondratieff (wrote so in his book *The Long Waves in Economic Life,* 1925).

He argued that capitalism was a stable system (the business cycle of 50 years implied it), in contrast to the Marxist view that it was self-destructive and unstable–he died in one of the Stalin’s prisons.

LAF

The abbreviated form of the Liquidity Adjustment Facility, is part of a financial policy provided to the banks by the RBI in India. The facility commenced in June 2000 under which the banks operating in India are allowed to park their funds with the RBI for short-term periods (i.e., less than one year which is usually from one day to seven days, in practice), known as the *Reverse Reop*. On such deposits to the RBI, the banks get an interest rate of 6 per cent per annum at present.

LAFFER CURVE

A curve devised by the economist Arthur Laffer in 1974 which links average tax rates to total tax revenue. It suggests that higher tax rates initially increase revenue but after a point further increases in tax rates cause revenue to fall (for instance by discouraging people from working). But it is tough to know whether an economy is on the Laffer curve, as higher taxation breeds evasion of taxes too.

LIAR LOANS

A term associated with the financial world which created news after the US financial system was hit by the subprime crisis in mid-2007.

These are the loans wherein borrowers fraudulently mis-state their incomes often egged on by the lender or broker to the bank. Such frauds have been detected along the entire US mortgage financing chain by September 2007–websites freely advertised that for a nominal fee, they could produce sufficient proof of income by generating bank statements, pay slips, income tax returns, and provide references. Lenders in turn *lied* about the real terms and conditions of the loans to borrowers and lied about the quality of loans sold to investors. The whole gamut of these deeds make such mortgage loans the *'liar loans'*.

LIBOR

The London Interbank Offered Rate (LIBOR) is the interest rate on dollar and other foreign currency deposits at which larger banks are prepared to borrow and lend these currencies in the Eurocurrency market. The rate reflects market conditions for international funds and are widely used by the banks as a basis for determining the interest rates charged on the US dollar and foreign currency loans to the business customers.

LIFE-CYCLE HYPOTHESIS

An idea which states that current consumption is not dependent solely on current disposable income of the consumers but is related to their anticipated lifetime income. This hypothesis has its high applied value in the real life economic management.

LIFE INSURANCE: SOME IMPORTANT TERMS

Endowment Policy

Insurance policies where a lump sum is payable either at the end of the policy term or if the insured dies during the policy tenure, are termed as endowment policies.

Beneficiary

A person or organisation legally entitled to receive benefits.

Term Life Insurance

In most cases, term life insurance refers to a product that provides death benefit protection for a specified period of time, say for 30 years. Benefits are doled out under this scheme only if the insured dies during the term.

Whole Life Insurance

It is a policy that provides insurance coverage for the entire life of the individual for a fixed premium throughout his life insurance, coupled with an investment component. Investments could be made in stocks or bonds that lead to accumulation of cash values. The augmented cash reserves are returned once one decides to surrender the policy.

Universal life insurance was created to provide more flexibility than whole life insurance by allowing the policy owner to shift money between the insurance and saving components of the policy.

Variable Universal Life Insurance Policy

A form of whole life insurance policy, this is a policy for those who weigh high risk threshold. It offers cash values that fluctuate based on the performance of the underlying mutual funds in the investment account. It is this investment of premiums in the equity market that carries with it an element of uncertainty.

Premium

This is the amount that the policy holder pays to the insurance company for the benefits provided under an insurance policy. The frequency of premium payments is opted by the individual. Typical premium modes include monthly, quarterly, semi-annual, and annual.

Annuity

An agreement sold by a life insurance company that provides fixed or variable payments to the policy holder, either immediately or at a future date.

Group Life Insurance

A life insurance policy issued to a group of people, usually through an employer.

Lapse

Defaulting on premium payments leads to the termination of an insurance policy. A lapse notice is sent in writing to the policy holder when the policy has lapsed.

Lump Sum

It refers to the proceeds of the policy that is paid to the beneficiary all at once rather than in installments. Typically, most life insurance policies make lump sum payment settlements.

LIQUIDATION

A process of 'winding up' a joint-stock company as a legal entity.

LIQUID ASSET

The monetary asset that can be used directly as payment.

LIQUIDITY

The extent to which an asset can be quickly and completely converted into currency and coins.

LIQUIDITY PREFERENCE

A term denoting a preference among the people for holding money instead of investing it.

LIQUIDITY TRAP

A situation when the interest rate is so low that people prefer to hold money rather than invest it.

In such situations investors do not go to increase investment even if the interest rates on loans are decreased. J. M. Keynes suggested for increased government expenditure or reduction in taxes to fight such a situation.

L-M SCHEDULE

Here 'L-M' stands for 'liquidity-money'. This is a schedule showing the combinations of levels of national income and interest rates where the equilibrium condition for the monetary economy, L = M, holds.

LOCAL AREA BANK

Announced in the Union Budget 1996–97 to ensure a focussed savings and credit mobilisation by defining the clear boundary of operation, the Local Area Bank (LAB) operates to a narrow geographical area of three contiguous districts. The private sector is also allowed entry in the segment.

LOCOMOTIVE PRINICIPLE

The idea that in a situation of worldwide *recession* (see the chapter *Business Cycle*), increase in the total demand in one economy stimulates economic activities in the other economies via foreign trade.

LORENZ CURVE

A graph showing the degree of inequality in income and wealth in a given population or an economy. It is a rigorous way to measure income inequality. In this method (for example), personal incomes in an economy are arranged in increasing order; the cumulative share of total income is then plotted against the cumulative share of the population. The curve's slope is thus proportional to per capita income at each point of the population distribution. In the case of complete equality of income, the Lorenz curve will be a straight line and with greater curvature the inequality rises proportionally–the *Gini Coefficient* measures this inequality.

LUMP OF LABOUR FALLACY

The fallacy in economics that there is a 'fixed amount of work' to be done i.e. a lump of labour –this may be shared in different ways to create fewer or more jobs in an economy. An economist, D.F. Schloss in 1891 called it the lump of labour fallacy because in reality, the amount of work to be done is not fixed.

MACRO & MICRO ECONOMICS

In economics, two different ways of looking at the economy have been developed by economists i.e., macroeconomics and microeconomics.

Macroeconomics ('macro' in Greek language means 'large') looks at the behaviour of the economy *as a whole* such as the issues like inflation, rate of unemployment, economic growth, balance of trade, etc. It is the branch of economics which studies the economy in its *total* or *average* term.

Microeconomics (in Greek language 'micro' means 'small') looks on the behaviour of the *units* i.e. the individual, the households, the firms, a *specific* industry–which together make up the economy.

MARGINAL STANDING FACILITY (MSF)

Operationalised on the lines of the existing Liquidity Adjustment Facility (LAF – Repo) in May 2011 under which all Scheduled Commercial Banks can avail overnight funds, up to one per cent of their Net Demand and Time Liabilities (NDTL) outstanding at the end of the second preceding fortnight.

The facility is availed at an interest which is 100 basis points above the LAF repo rate, or as decided by the Reserve Bank from time to time. At present it is 9 per cent.

MARGINAL UTILITY

The increase in satisfaction/utility a consumer derives from the use/consumption of one *additional* unit of a product in a particular time period–it goes on decreasing, i.e., the *diminishing marginal utility*.

MARKET CAPITALISATION

A term of security market which shows the market value of a company's share–calculated by multiplying the current price of its share to the total number of shares issued by the company.

MARKET MAKER

An intermediary (may be an individual or a firm) in the secondary market who buys and sells securities/shares simultaneously quoting two-way rates. For example, on the Over the Counter Stock Exchange of India (OTCEI) only 'market markers' are allowed to operate. The Discount and Finance House of India (DFHI) is the chief market maker in the 'money market' of India.

A market maker plays a very vital role by providing sustainability to liquidity in the secondary market.

MASCs

The Multi-Application Smart Cards (MASCs) system to facilitate simplification of procedures and enhancing the efficiency of Government schemes has been suggested by a Planning Commission Working Group in the context of the Eleventh Five-Year Plan. The ***Smart Card*** (i.e., MASCs) has been recognised to be useful in implementation of various Central government schemes like, PDS, Indira Awas Yojana and National Rural Employment Guarantee Scheme (NREGS).

Based on a web-enabled information system the Smart Cards will be based on unique ID, sharing ID, multi-application and access control. The whole system will consist of front, middle, and back end. The electronic card will be the 'front' end of the system which will be the point of delivery where the smart cards will be read and used. The office at 'middle' will be responsible for changing and updating the card periodically (i.e. monthly, quarterly, annually) depending on the type of information and requirement and transfer information from the front end to the back end and vice versa. The office at 'back' end will contain the computerised records, guidelines, accounts and management information systems. The complete digitisation of records will be required by this system.

MARSHALL PLAN

A programme of international aid named after General George Marshall (a US Secretary of State) under which North America contributed around 1 per cent of its GDP in total (between 1948–52) to western Europe to rebuild the economies ravaged in Second World War.

MENU COST

The cost a firm bears in changing the prices of its product–it includes retraining the sales staff, reprinting of the new price list, labelling of goods, and informing the customers about the price change. Higher menu costs discourage the firms going for frequent price changes.

MID-CAP FUNDS

Mutual funds launch sector-specific funds to attract investments. Similarly, they mobilise resources from investors with an objective of investing in mid-cap shares. The Fund Manager chooses the mid-cap shares that can become a part of the portfolio. His job is to outperform the benchmark like the CNX Midcap 200 indexes in terms of the returns. There are thousands of funds world over that focus on investing in medium or small-cap companies.

MFBS

In August 2007, the Reserve Bank of India released a Manual on Financial and Banking Statistics (MFBS), first of its kind, which works as a reference guide and provides a methodological framework for compilation of statistical indicators encompassing various sectors of the economy.

MID-CAP SHARES

There is no classical definition of mid-cap shares. The name ‘mid-cap’ originates from the term, *medium capitalised.* It is based on the market capitalisation of the stock. Market capitalisation is calculated by multiplying the current stock price with the number of shares outstanding or issued by the company. The definition of mid-cap shares can vary across markets and countries. In case of India, the National Stock Exchange defines the mid-cap universe as stocks whose average six months market capitalisation is between Rs. 75 crore and Rs. 750 crore. In the US, mid-cap shares are those stocks that have a market *capitalisation* of Rs. 9,000 crore to Rs. 45,000 crore. In India, these shares will be classified as *large cap shares.* Thus, classification of shares into large-caps, mid-cap and small-cap is made on the basis of the relative size of market in a country. The total market capitalisation of US markets is $15 trillion. In India, the market capitalisation of listed companies is

around $600 billion.

The theory is that large-cap shares have lesser growth potential since the turnover and profits of large companies are already high in the context of that particular market. On the other hand, mid-cap shares are considered an attractive avenue for investing because their growth rate should be faster. It is analogous to investing in an emerging market, like India, as compared to a mature market. However, on the flip side, mid-cap shares are of small companies where revenue and profits could be more volatile than large companies. At the same time, the availability of shares for trading in the secondary market is also limited in comparison to large-cap shares.

The *free float factor*, as it is called, is a key to active trading in shares since investors want an easy entry and exit. Typically, the promoter holding in these companies is high and there is very little public shareholding. Thus, a volatile financial performance and an inadequate free-float make investing in mid-cap shares more risky than big company shares. Moreover, the faster growth argument is obviously a generalisation which may or may not hold for individual companies.

The National Stock Exchange manages an index called CNX Midcap 200. The objective of such an index is to capture the movement in the mid-cap shares segment. According to the NSE, CNX Midcap 200 represents about 77 per cent of the total market capitalisation of the mid-cap universe and 75 per cent of the total trade value. This index provides investors a broad-based benchmark for comparing portfolio returns in the mad-cap segment.

MERCHANT BANKING

A financial world business of providing various financial services other than lending such as public issue management, underwriting such issues, loan syndication management, mergers and acquisition related services, etc.

MEZZANINE FINANCING

Mezzanine financing is defined as a financial instrument which is a *mix* of 'debt and equity' finance. It is a debt capital that gives the lender the rights to convert to an ownership or equity interest in the company. It is listed as an asset on company's balance sheet. As it is treated as equity in a company's balance sheet, it allows the company to access other traditional sources of finance.

In the hierarchy of creditors, mezzanine finance is subordinate to *senior debt* but ranks higher than *equity*. The return on mezzanine finance is higher in relation to debt finance but lower than equity finance. It is also available quickly to the borrower with *little* or *no collateral*. The concept of mezzanine financing is just catching up in India. Mezzanine financing is used mainly for small and medium enterprises, infrastructure and real estate. *ICICI Venture's Mezzanine Fund* was the first fund in India to focus on mezzanine finance opportunities.

MIBID

The Mumbai Inter Bank Bid (MIBID) is the weighted average interest rate at which certain banks in Mumbai are ready to borrow from the call money market.

MIBOR

The Mumbai Inter Bank Offer Rate (MIBOR) is the weighted average interest rate at which certain banks/institutions in Mumbai are ready to lend in the call money market.

Middle Class

We keep hearing and reading use the term ‘middle class’ frequently. But who are the middle classes? There are still no universally accepted criteria for defining the middle class. Simply put, they are neither rich nor poor. Even the income criterion has not been settled. According to the National Council of Applied Economic Research (NCAER), a family with an annual income between Rs. 3.4 lakh and Rs. 17 lakh (at the 2009-10 price levels) falls in the middle class category. According to NCAER, by 2015-16, India will be a country of 53.3 million middle class households or about 267 million people.

Microcredit

Smaller credit/loan to small and needy borrowers who are outside the reach of commercial banks, for the purpose of undertaking productive activities.

Misery index

An index of economic misery that is sum of the rates of inflation and unemployment for an economy–higher the value greater is the misery.

Monetary Neutrality

The idea that changes in money supply have no effect on real economic variables (such as output, real interest rates, unemployment etc.,) if money supply increases by 10 per cent, for example, the price will increase by the same level.

A core belief of Classical Economics, the idea was put forth by David Hume in the 18^{th} century. Today this is not considered a valid idea.

MONEY ILLUSION

A phrase coined by J. M. Keynes to denote the misleading thinking among people that they are getting richer as a result of inflation when in reality the value of money decreases.

The phrase is used by some economists to argue that a small amount of inflation may not be a bad thing and could even be beneficial as it may help to ‘grease the wheels’ of the economy – a feeling of

getting richer (let it be illusory itself!).

MORAL HAZARD

One among the two kinds of market failure often associated with the insurance sector. It means that the people with insurance cover may take greater risks than the uncovered ones as they know they are protected so the insurer may get more claims it bargained for. the other kind of market failure is the *adverse selections* also related to insurance business.

MOST FAVOURED NATION

As per the WTO agreements, member countries cannot *normally* discriminate between their trading partners. If any country grants one country a special favour such as a lower customs duty rate for one of their products the same would need to be extended to all other WTO members. This principle is known as Most Favoured Nation (MFN) treatment.

MFN is governs trade in ***goods***. MFN is also a priority in the General Agreement on Trade in ***Services*** (GATS) and the Agreement on Trade-Related Aspects of ***Intellectual Property*** Rights (TRIPS). However, there are some *exceptions* under WTO regime which allow mwmber countries to –

(i) Set up a 'free trade agreemen't that applies only to *goods* traded within the group (discriminating against goods from outside).

(ii) Give developing countries special access to their markets.

(iii) Raise barriers against products that are considered to be traded unfairly from specific countries.

(iv) To discriminate, in limited circumstances, in services.

But the agreements only permit these exceptions under strict conditions. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services for all its trading partners whether developed or developing.

MULTI-FIBRE ARRANGEMENT (MFA)

Up to the end of the Uruguay Round (1986–94), textile and clothing trade were negotiated bilaterally and governed by the rules of MFA, introduced in 1974. This provided for the application of selective quantitative restrictions (quota) when surges in imports of particular products caused, or threatened to cause, serious damage to the industry of the importing country. The Multi-fibre Arrangement was a major departure from the basic GATT rules and particularly the principles of non-discrimination.

On January 1, 1995 MFA was replaced by the WTO Agreement on Textiles and Clothing (ATC) which sets out a transitional process for the ultimate removal of these quotas in stages. The MFA regime, however, continued till December 31, 2004 until quota was completely phased out.

In the MFA regime, higher quota was allocated to various countries irrespective of cost competitiveness. Apparel exports from countries like Nepal, Bangladesh, Sri Lanka, Taiwan, and other South East Asian nations thrived due to quota protection in the lucrative EU and the US markets. But most of these nations lack competitive edge. Their market share was expected to be grabbed by countries like China and India as they offer cheaper and better products.

The ATC was a transitional instrument meant for progressively integrating textile and clothing products into GATT 1994. It laid down the integration procedure and stipulated how members should integrate textile products into the rules of GATT 1994 over the 10-year period which ended on December 31, 2004. The process was to be carried out progressively in three stages (3, 4, and 3 years) with all textile products being integrated at the end of the 10-year period.

First stage began on January 1, 1995 with the integration by members of products representing not less than 16 per cent of its total 1990 imports of all products under quota. At stage 2, on January 1, 1998, not less than a further 17 per cent was integrated. At stage 3, on January 1, 2002, not less than a further 18 per cent was integrated. Finally at the end, on January 1, 2005, all the remaining products (amounting upto 49 per cent of 1990 imports into a member) stood integrated and the ATC was terminated.

MUTUAL FUNDS

The key consideration while investing in a mutual fund are *safety, liquidity*, and *return.* Safety is assured when investors are able to get back their money. Liquidity enables investors exit the fund any time. There are no assured returns from mutual funds and they vary with the scheme under each fund. The schemes are structured to suit the risk-bearing capacity of unit holders and the nature of deployment of funds by the various schemes.

The structure of mutual funds is governed by the Securities and Exchanges Board of India under the SEBI (Mutual Fund) Regulations 1996. These regulations make it mandatory for mutual funds to have a three-tier structure–a sponsor, a trustee, and an asset management company (AMC). The sponsor is the promoter of the mutual fund and appoints the trustees. The trustees are responsible to the investors in the mutual fund and appoint the AMC for managing the investment portfolio.

The AMC is the business face of the mutual fund, as it manages all the affairs of the mutual fund. The mutual fund and the AMC have to be registered with the SEBI. SEBI regulations also provide for who can be a sponsor, trustee, and AMC, and specify the format of agreements between these entities. These agreements provide for the rights, duties, and obligations of these three entities.

Mutual funds are the preferred route for investors, particularly small and retail investors, who do not have the knowledge or time to directly trade in the equity and debt markets. The funds are managed by qualified investment professionals and other service providers who are paid for their services. Portfolio diversification, professional management, and, reduced risk are among the myriad advantages of mutual funds.

Mutual funds invest in multiple asset classes, enable continuous evaluation and provide higher flexibility in investment plans.

Investors in mutual funds have a wide choice from an assorted variety of funds and schemes with

several products on offer. Competition in the industry has led to innovative changes in standard products by fund houses. The product choice enables investors to choose options that suit their return requirement and risk appetite. They can combine the options to arrive at their own mutual fund portfolios that will fit their financial planning objectives. The funds are invested in a portfolio of marketable securities, reflecting the investment objective. The value of the portfolio and investors' holdings alter with change in the market value of investments.

Mutual funds predominantly invest in equity shares and debt instruments. Under *equity funds,* one can invest in diversified equity schemes, primary market schemes, index based funds, and sectoral funds.

Debt funds invest predominantly in debt markets. Diversified debt funds, income funds, gilt funds, liquid and money market funds, fixed term plans, and floating rate funds are among the categories of debt funds. While equity funds suit growth objectives, debt funds fit income objectives.

Mutual fund houses also offer *balanced funds* and *money market funds.* Balanced funds invest in equity and debt in specified proportions while money market funds are preferred by institutional investors which churn their investments depending on the need and view.

NARROW BANKING

Short-term lending in risk-free asset is narrow banking. A suggestion for such banking was given by the Committee on Financial System (CFS) in 1991 for the weak banks of India.

NASDAQ

The National Association of Security Dealers Automated Quotation (NASDAQ) is a US stock exchange based in New York which specialises in the high-tech companies' shares. A similar exchange *Techmark* exists in London too. (It is an arm of the London Stock Exchange.)

NASH EQUILIBRIUM

A concept in game theory named after John Nash, a mathematician and Nobel prize winning economist, which occurs when each player is pursuing their best possible strategy in the full knowledge of the strategies of all the other players–once the equilibrium is reached, none of the players has any incentive to change their strategy.

NEO-CLASSICAL ECONOMICS

The school of economics based on the writings of Alfred Marshall (1842–1924) which replaced the classical economics by the 19th century, also known as the *'marginal revolution'*.

NEW PENSION SCHEME

Pension reforms in India have evolved primarily in response to the need of reform in the Government pension system. This had been designed to make a shift from defined-benefit to defined-contribution by putting a cap on Government's liability towards civil servants' pension. As a result of implementation of the New Pension System (NPS), all employees of the Central Government and Central autonomous bodies, with the exception of the armed forces, are now covered by this defined-contribution scheme with effect from January 1, 2004. Subsequently, 27 State Governments have notified and joined the NPS for their employees. The NPS to was opened to all citizens of India on May 1, 2009, on voluntary basis - the challenge is to spread the message of the NPS and old age income security to people in the unorganized sector across the country.

The pension fund managers manage three separate schemes, consisting of three asset classes, namely (i) equity, (ii) Government securities, and (iii) credit risk-bearing fixed income instruments, with the investment in equity subject to a cap of 50 per cent.

NINJA

A mortgage business terminology became common word after the US subprime crisis of mid-2007 which is an acronym for the borrowers with no income, no job or assets.

NOMINAL VALUE

The value of anything calculated at the current prices. It does not include the effect of inflation during the periods and gives misleading idea of value.

NON-WORKERS

The *Census of India* defines non-workers as the persons who did not 'work at all' during the reference period. They constitute –

(i) Students who did not participate in anyeconomic activity paid or unpaid,

(ii) Household duties who were attending to daily household chores like cooking, cleaning utensils, looking after children, fetching water etc. and are not even helping in the unpaid work in the family farm or cultivation or milching,

(iii) Dependants such as infants or very elderly people not included as *worker*,

(iv) Pensioners drawing pension post-retirement, not engaged in any economic activity.

(v) Beggars, vagrants, prostitutes and persons having unidentified source of income and with unspecified sources of subsistence and not engaged in any economically productive work.

(vi) Others, which includes all Non-workers who may not come under the above categories such

as rentiers, persons living on remittances, agricultural or non-agricultural royalty, convicts in jails or inmates of penal, mental or charitable institutions doing no paid or unpaid work and persons who are seeking/available for work.

[Also see entry *'Worker'* also.]

NORKA

Indians work abroad and *remit* much of their earnings back home. Kerala is a state where non-residents contribute significantly to the state's resources. Keeping this important revenue channel in mind, the Government of Kerala launched the department of Non-resident Keralites' Affairs (NORKA) in 1996 to redress the grievances of Non-Resident Keralites (NRKs). NORKA is the ***first*** of its kind formed by any Indian state.

It makes efforts to solve the grievances raised in petitions for remedial action on threats to the lives and property of those who are left at home, tracing of missing persons abroad, compensation from sponsors, harassment from sponsors, cheating by recruiting agents, educational facilities for children of NRKs, introduction of more flights, assistance to stranded Keralites, etc.

NORKA has established *NORKA Roots* that acts as an interface between the NRKs and the Government of Kerala. Some important *objectives* are creation of a heritage village for parents of non residents, cultural exchange programmes, promotion of Malayalam language, employment mapping, maintaining a data base etc.

NORMAL GOODS

The goods whose demand increases as income of the people increases. It is just opposite of *inferior goods*.

NULL HYPOTHESIS

An idea that is put to the test. In econometrics, experts start with a null hypothesis (i.e. a particular variable equals a particular number), then crunch the data to verify it in accordance with the laws of *statistical significance*. The chosen null hypothesis is often just opposite to what the experimenter believes.

Statistical significance means that the probability of getting the result by chance is low. It is most commonly used measure is that there must be a 95 per cent chance that the result is right and only 1-in-20 chance of the result occurring randomly.

NUMERAIRE

A monetary unit which is used as the basis for denominating international exchanges in a product and financial settlements on a common basis. For example, the US dollar being used as the numeraire of international oil trade, the Special Drawing Rights (SDRs) as the numeraire of the IMF transactions, etc.

NVS

Non Voting Shares (NVS) are the equity shares not having right to vote at the general meetings of the company. But these shares get higher dividend than the shares having voting rights. A company in India may issue such shares maximum to the 25 per cent of the total issued share capital and such shares cannot get more than 20 per cent higher dividend than the shares with voting rights.

OIL BONDS

Over the last few months there have been many reports on India state-owned oil refining companies like IOC, BPCL, and HPCL reeling under the impact of the rise in crude oil prices. These companies have been hit as they are unable to pass on the rise in price to the consumer due to heavy subsidies on some products. With the oil companies being heavily impacted in the first quarter of this financial year, the government has finally agreed to a package, which proposes issuance of special oil bonds.

The oil bonds are special bonds issued by the government to partly compensate state-owned oil companies for not increasing the retail prices of products like LPG and Kerosene in line with the rise in crude oil prices.

OKUN'S LAW

Based on the empirical research of *Arthur Okun* (1928–80), the law describes the relationship between unemployment and growth rate in an economy. As per it, if GDP grows at 3 per cent p.a., the unemployment rate would not change. In the case of faster growth rates, every extra above the 3 per cent will have a decrease in the unemployment rate by its half (i.e., a 4 per cent growth rate will decrease unemployment by 0.5 per cent–half of 1 which is the extra above 3 per cent). Similarly, a growth rate below 3 per cent will have the same but opposite impact on unemployment (i.e., increases it).

Though the law was perfectly correct for the period of the US economy Okun studied, it may not be valid today in either US or anywhere else. But in general, the law is still used by experts and policy makers as a rule of thumb to estimate the relationship between growth rate and job creation.

OPEN MARKET OPERATION

An instrument/tool of monetary policy under which sale/purchase of government Treasury Bills and

bonds takes place as a means of controlling money supply.

OPPORTUNITY COST

A measure of the economic cost of using scarce resources to produce one particular good or service in terms of the alternative thereby foregone, also known as the *economic cost*.

OUTCOME BUDGET

An outcome budget measures the development outcomes of all government programmes. For instance, it will tell a citizen if money has been allocated for building a primary health centre, whether the centre has indeed come up. In other words, it is a means to develop a linkage between the money spent by a government and the results, which follows. The concept has developed in many democratic systems to make budgets more cost-effective. According to experts, it signals the emergence of an important tool for effective government management and accountability. Earlier too, there have been efforts to bind government expenditure to results, like zero-based budgeting. But experts acknowledge that an outcome orientation is a better means to achieve the same objective. In India, the central government decided that with effect from the fiscal year 2006–07, it will put up in the public domain information about spending by ministries so that all stakeholders, including the people's representative, civil society and the intended beneficiaries of the schemes and projects can scrutinise how well a project has been implemented. This will ensure value for money for government expenditure.

This means, every ministry would have to present its preliminary outcome budgets while proposing its demand for grants to the Ministry of Finance. It is a sort of examination of expenditure before they are made, instead to a post expenditure scrutiny. The Expenditure Finance Committee, for instance, which sanctions government plans of upto Rs. 100 crore, has recently modified its rules and decided to ask of real definition of outcomes at the stage of planning a programme. 'At the end of the year, we should ask not how much has been spent, but what has been achieved,' the Finance Minister has said explaining the rationale for the exercise. Admitting that converting outlays into outcomes is a complex process, which may differ from ministry to ministry and programme to programme. The Finance Minister said administrative ministries have to develop a commitment to make the exercise successful.

In addition, converting outlay into outcomes will require ensuring the flow of right amount of money at the right time to the right level, with neither delays nor 'parking' of funds; effective monitoring and evaluation systems, which indicate the areas requiring further calibration and honing of processes to deliver the intended outcomes; and the involvement of the community or target groups for whom the schemes are meant.

The exercise is a joint effort of the Finance Ministry and the Planning Commission. The latter gave final shape to the consolidated Outcome Budget of the administrative ministries after detailed discussion with them. The document will also be put up on the web for the people to give their comments.

A new division called the Programme Outcome and Response Monitoring Division has been created within the Planning Commission to co-ordinate the initiative. The Division will try to bring a fair Degree of uniformity of approach across the Ministries, but with due regard to the special nature of their collective responsibilities, programmes, and projects. This means that while it is relatively easy to find out if the defence ministry has spent its budget to buy a new weapons system, it is far more difficult to establish if Rs. 100 crore spent on a block has helped families to move above the poverty line. So the yardsticks have to take into account such differences.

Some of the common yardsticks to be employed to measure outcome include standardising the unit cost of delivery, bench-marking the standards and quality of outcome, and capacity-building of requisite efficiency at all levels, in terms of equipment, technology, knowledge and skills. Accordingly, implementing agencies will have a clearer idea of what is expected of them, and can be assessed against agreed performance indicators.

OVER THE COUNTER

The financial papers/securities which can be bought or sold through a private dealer or bank rather than on a financial exchange. The term has its use in the non-financial world too–purchasing medicines from a medical store without the doctor’s prescription is an over-the-counter deal in drugs.

PARALLEL IMPORTING

A type of arbitrage where an independent importer buys product of a particular supplier at low price in one country and resells it in direct competition with the supplier’s distributors in another country where prices are higher.

It promotes free trade and competition by breaking down barriers to international trade and undermines price discrimination between markets covered by the suppliers.

PARETO PRINCIPLE

The maximisation of the economic welfare of the community. Named after the Italian economist Vilfredo Pareto (1843–1923), this points to a situation in which nobody can be made better off without making somebody else worse off.

By an efficient use of resources an economy is able to do so i.e., without making somebody else worse off, somebody might be made better off. In reality, change often produces losers as well as winners. Pareto optimality does not help judge whether this sort of change is economically good or bad.

PARKINSON’S LAW

A proposition by C. Northcote Parkinson which suggests that work expands according to the time available in which it is done.

PENNY STOCKS

Very low-priced shares of small companies which have low market capitalisation. The term made news in mid-2006 when some of the 'penny stocks' did show a high rise in their trading prices in India at the BSE as well as the NSE.

PHILLIPS CURVE

A graphic curve depicting an empirical observation of the relationship between the level of unemployment and the rate of change of money wages and, by inference, the rate of change of prices.

It was in 1958 that an economist from New Zealand, A. W. H. Phillips (1914–75) proposed that there was a trade-off between inflation and unemployment–the lower the unemployment rate, the higher the inflation rate–governments simply need to choose the right balance between the two evils.

PIGGYBACK LOAN

A term associated with mortgage business got popular in the wake of the US subprime crisis mid-2007. Piggyback loan is a second mortgage enabling a borrower to buy a house with little or no equity.

PIGOU EFFECT

Named after Arthur Cecil Pigou (1877–1959), a sort of wealth effect resulting from deflation/disinflation (i.e., price fall) – a fall in price level increases the real value of people's money, making them wealthier inducing increased spending by them; higher demand creation leads to higher employment.

PFRDA

In 2002–03, the government announced its intention to move toward a new pension scheme. The reason for this change was the growing liabilities of both the Central and state governments on account of pension payments. These liabilities are discharged by the government out of general revenues, instead of a specific dedicated sustainable fund. Recognising the inherent dangers, an interim Pension Fund Regulatory Development Authority (PFRDA) was set up on January 1, 2004. Subsequently, the Interim authority was disbanded and an Ordinance was promulgumated in late

December 2004, followed up with the PFRDA bill in the budget session of Parliament.

The PFRDA will be a regulator on the lines of the watchdogs for insurance and capital market, to regulate and supervise pension funds in the country. It will regulate the new pension scheme which has been in vogue since January 1, 2004 for all fresh entrants to the central government, excusing the armed forces. The PFRDA will also regulate the new pension schemes announced by state governments besides all gratuity and superannuating funds. However, other social security schemes which are in operation now like the one offered by Employees Provident Fund, Coal Miners Provident Fund, Seaman Provident Fund, Assam Tea Provident Fund, to name a few, will be out of the purview of PFRDA as they are governed by specific legislations.

Besides regulation of pension funds, the PFRDA will also have a promotional role to play like other regulators in the country. This will also mean an educational awareness role also. The pension fund regulator will evolve guidelines in consultation with the government on opening up of the pension sector. The PFRDA will also have to curb fraudulent and unfair practices in the sector by participants and protect the interests of subscribers. A pension fund subscriber education and protection fund will also be set up down the line in keeping with its mandate.

The PFRDA will decide on how many pension fund managers ought to be allowed initially, the kind of schemes, the norms for selection of the pension fund managers, capital requirements for these players and the investment norms for the pension funds.

It will also grant licences to pension fund managers. In short, all the operational guidelines for pension fund management will be laid down by the PFRDA. Besides, the regulator will also prescribe the level of investment by the pension fund managers in various types of instruments, whether debt or equity, both in the local and overseas markets.

PREFERENCE SHARES

The shares which bear a stated dividend and carry a priority over equity shares (in matters of dividend and assets) are also known as hybrid securities (since they have the qualities of equity shares as well as bond). Such shares in India cannot have a life over 10 years.

PRICE-EARNING RATIO

A concept used in the share market to equate various stocks–is a ratio found/calculated by dividing market price of a share by the earning per share.

PRIMARY AND SECONDARY MARKET

Primary market refers to buying of shares in an initial public offering. The shares are bought by applying through a share application form. Secondary market refers to transactions where one

investor buys shares from another investor at the prevailing market price or at an agreed price. The shares are bought and sold in the secondary market on the stock exchanges. The investors may buy and sell securities on the stock exchanges through stock brokers.

PRIMARY DEALER

Primary dealer (PD) is an intermediary participating in the *primary* auctions of the government securities (i.e., G-See or the Gilt-edge securities or the Gilt) and the Treasury Bills (TBs); through a PD these instruments reach the secondary market.

Primary dealers are allowed participation in the call money market and notice money market. They get liquidity support from RBI via repos or refinance (against the G-Secs.).

PRISONER'S DILEMMA

A popular example in *game theory* which concludes why co-operation is difficult to achieve even if it is mutually beneficial, ultimately making things worse for the parties involved. It is shown giving an example of two prisoners arrested for the same offence held in different cells. Each prisoner has two options, i.e., confess, or say nothing. In this situation there are *three* possible outcomes:

(i) One could confess and agree to testify against the other as a state witness, receiving a light sentence while his fellow prisoner receives a heavy sentence.

(ii) They can both say nothing and may turn out to be lucky getting light sentences or even be let off due to lack of firm evidence.

(iii) They may both confess and get lighter individual sentences than one would have received had he said nothing and the other had testified against him.

The second outcome looks the best for both the prisoners. However, the risk that the other might confess and turn state witness is likely to encourage both to confess, landing both with sentences that they might have avoided had they been able to co-operate by remaining silent.

In reality, firms behave like these prisoners, not setting prices as high as they could do if they only trusted the other firms not to undercut them. Ultimately, the firms are worse off i.e. all firms suffer.

POPULATION TRAP

A situation of population growth rate greater than the achievable economic growth rate. This makes it difficult to alleviate poverty;–government is suggested to implement population control measures.

POVERTY TRAP

A situation where an unemployed getting unemployment allowance is not encouraged to seek

work/employment because his/her after-tax earnings as employed is less than the benefits as unemployed–also known as the *unemployment trap*.

PREDATORY PRICING

The pricing policy of a firm with the express purpose of harming rivals or exploiting the consumer. By price-cutting, firstly the rivals are ousted from the market and later the consumers are exploited as monopolistic suppliers by the firm.

PPP

Purchasing power parity (PPP) is a method of calculating the correct/real value of a currency which may be different from the market exchange rate of the currency. Using this method economies may be studied comparatively in a common currency. This is a very popular method handy for the IMF and WB in studying the living standards of people in different economies. The PPP gives a different exchange rate for a currency which may be made the basis for measuring the national income of the economies. It is on this basis that the value of gross national product (GNP) of India becomes the fourth largest in the world (after the US, Japan, and China) though on the basis of market exchange rate of rupee it stands at the *thirteenth rank*.

The concept of the PPP was developed by the great European conservative economist, Gustav Cassel (1866–1944), belonging to Sweden. This concept works on the assumption that markets work on the *law of one price,* i.e., identical goods and services (*in quantity* as well as *quality*) must have the same price in different markets when measured in a common currency. If this is not the case it means that the purchasing power of the two currencies is different.

Let us look at an example. Suppose that sugar is selling $1 in US and Rs. 20 in India a kilo then the PPP-based exchange rate of rupee will be $1 = Rs. 20. This is the way how *The Economist* of London has prepared its 'Big Mac Index' (comparing the Mc Donald's Big Mac burger prices in different economies).

In theory, the value of currencies in terms of their market exchange rate should converge with their value in terms of the PPP in the long run. But that might not happen due to many factors like the fluctuations in inflation; level of money supply; follow-up to the exchange rate regimes (fixed, floating, etc.), and other.

For the calculation of the PPP, a comparable basket of goods and services is selected (a very difficult task) of the identical qualities and quantities. The other difficulty in computing PPP arises out of the flaw in the 'one price theory' i.e., due to transportation cost, local taxes, level of production, etc. The prices of goods and services cannot be the same in different markets (This is correct in theory only, not possible in practice.)

QIP

Qualified Institutional Placement (QIP) is a policy associated with the Indian stock market for raising capital by issuing equity shares. The companies listed on the BSE and the NSE are allowed (since May 2006) to raise capital by issuing equity shares, or any securities other than warrants, which are convertible into or exchangeable with equity shares. The attractive part of the new QIP is that the issuing company does not have to undergo elaborate procedural requirements to raise this capital. These securities have to be issued to Qualified Institutional Buyers on a discretionary basis, with just a 10 per cent reservation for mutual funds.

Q THEORY

As investment theory for firms proposed by the Nobel prize winning (1981) economist James Tobin (1918–2002). He theorised that firms would continue to invest as long as the value of their shares exceeded the replacement cost of their assets–the ratio of the market value of a firm to the net replacement cost of the firm's assets is known as *'Tobin Q'*. If Q is greater than 1, then it should expand the firm by investment as the profit it should expect to make from its assets (reflected by share price) exceeds the cost of the assets.

If Q is less than 1, the firm would be better off by selling its assets which are worth more than shareholders currently expect the firm to earn in profit by retaining them.

RANDOM WALK

When it is impossible to predict the next step. As per the Efficient Market Theory the prices of financial assets (such as shares) follow a random walk–there is no way of knowing the next change in the price. The reason this theory provides is that in an efficient market, all the information that would allow an investor to predict the next price move is already *reflected in the current price.* Such belief has led some economists to conclude that investors cannot outperform the market consistently.

As opposed to this, some economists argue that asset prices are predictable and that markets are not efficient–they follow a *non-random walk* perspective.

REDLINING

The act of not lending to people in certain poor or troubled neighbourhoods shown on the map with a 'red line'. Even if their credit-worthiness has been judged on the basis of other criteria, they are not considered as borrowers by the banks, simply because they live in that area.

RENT

It has two different meanings in economics:

(i) The first is layman i.e. the income accruing from hiring land or other durable goods.

(ii) The second (also known as *economic rent*) is a measure of *market power* i.e. the difference between what a factor of production is paid and how much it would need to be paid to remain in its current use.

For example, a cricket player may be paid Rs. 40,000 a week to play for his team when he would be willing to turn out for only Rs. 10,000, so his economic rent will be Rs. 30,000 a week.

RENT-SEEKING

Spending time and money not on the production of real goods and services, but rather on trying to get the government to change the rules so as to make one's business more profitable.

It is like cutting a bigger slice of the cake rather than making the cake bigger trying to make more money without producing more for customers. The term was coined by the economist Gordon Tullock.

RENT-SEEKING BEHAVIOUR

The behaviour which improves the welfare of someone at the expense of someone else. A protection racket is the most extreme example of it, in which one group (i.e., the protected one) betters itself without creating welfare-enhancing output at all.

REPLACEMENT COST

The cost of replacing an asset (such as machinery, etc.). Opposite to *historic cost* (i.e. the original cost of acquiring an asset), replacement cost adjusts the effects of inflation.

REPO, REVERSE REPO, & BANK RATE

It is a window which enables a bank or a financial institution to borrow money in the *short term.* In the transaction the entity in question sells government securities or bonds to be lender (another bank or institution), with an agreement to buy the securities back after a specified time and price. It is also called a *repurchase* agreement. (In the US, repo has different meaning; it is used to signify the repossession of hypothicated property by a financier).

A *repo* transaction is in the nature of secured borrowing; the difference between the sale and repurchase price is the borrowing cost. It is usually very short term in nature with the market practice being to conclude the sale and repurchase within a time frame of one day, to a fortnight.

When RBI conducts a repo what it does in effect is lend to banks by purchasing securities and selling

them back at a predetermined price. When RBI does a *reverse repo,* it borrows from banks by selling them securities and buying them back at a future date. When RBI does reverse repo, it enables banks to park short-term surplus funds; on the other hand, it's a tool for RBI to manage short-term liquidity. RBI pays an interest of 6 per cent to the banks on reverse repo today. The rate serves as a short term interest rate benchmark for banks and other intermediaries. Similarly, RBI makes funds available to banks through repo at 7.75 per cent today.

In India, only select institutions in the financial sector have RBI's permission to enter into repo and reverse repo transactions.

Significantly, on April 28, 2007, RBI, for the first time allowed listed corporates to participate in the repo market as lenders. Thus, a corporate treasurer can choose between a liquid mutual fund and repo to park surplus money in the short term.

Banks have been banned to do repo with brokerage. The ban, still in force was imposed after the '92 stock market scam masterminded by the late Harshad Mehta. Mehta used the repo/reverse repo operation with various banks as a subterfuge to divert funds to the stock market. After the scam, RBI came up with strict guidelines for repo transactions. It also limited the number of players in repo transactions to participants such as banks and primary dealers.

Unlike a general borrowing or lending transactions in the money market, repos are safer as the lender holds government securities (or other special bonds with the repo status) in its own name. Thus, a repo is a *zero-risk* transaction. A repo helps banks to meet their mandatory requirements for investing in government securities (i.e., the SLR). Under the law, banks are required to invest a certain portion of their deposits in government securities. If their holdings are not up to the prescribed level, they face punitive action. So, if a bank needs securities for a short period, it provides the opportunity.

There are two benchmark rates through which RBI influences interest rates in the system. The first is the *bank rate*–the rate at which it lends to banks. The second is the *reverse repo rate*–the rate at which it borrows funds from the banking sector–and repo rate–the rate at which it makes funds available to banks which need it. However, over the years, reverse repo and repo have emerged as the more dynamic indicators of the interest rates. Remember, the reverse repo rate acts as a floor for lending rates in the money market since banks have the option of lending to the Reserve Bank at the reverse repo rate if short-term money market rates fall below that level.

RESIDUAL RISK

What is left after one takes out all the other shared risk exposures to an asset, also known as *alpha* (a).

When one buys an asset one is exposed to a number of risks, many of them not unique to the asset but reflect broader possibilities (such as the future behaviour of stock market, interest rate, inflation or even government policies, etc.). Exposure to this risk can be reduced by diversification.

RETAIL BANKING

A way of doing banking business where the banks emphasise the individual-based lending rather than corporate lending–also known as *high street banking*. Such banking focusses on consumer loans, personal loans, hire-purchase, etc., considered more cumbersome and risky.

RETROCESSION

The term has got *three* different meanings in which it is used –

(i) The purchase of 'reinsurance' by a 'reinsurance company' (as in the case of India, the GIC going for 'reinsurance' on the 'reinsurance' it has provided to other 'insurance companies' operating in India). This limits the risk that a reinsurance company may face, since it has purchased insurance against an 'event' that might affect a company that it had underwritten (reinsured). If a reinsurance company *continues* to purchase insurance it might 'unknowingly' buy back its own risk, which is known as 'spiraling'.

(ii) The 'voluntary' act of returning ceded property by one to another which may be a result of 'request' to have property returned. But, by definition, it is not the result of a 'forced' transaction. Returning of Hong Kong to China by the UK in 1997 is the best such example of the recent times.

(iii) The act of 'differentiating' and 'diversifying' assets by consolidating and then dividing them amongst a number of stakeholders – by doing so the risk involved is 'retroceded' (i.e., cut down or minimised). This is, usually, done by the 'hedge funds' in their day-to-day portfolio management.

REVERSE TAKEOVER

The term is used to mean two different kinds of takeovers:

(i) Takeover of a public company by a private one, and

(ii) Takeover of a bigger company by a smaller one.

RESIDUAL UNEMPLOYMENT

Unemployment of those who remained unemployed even in the times of full employment (as for example employing a severely handicapped person may far outweigh the productivity obtained from him).

REVERSE MORTGAGE

A scheme for senior citizens in India announced in the Union Budget 2007–08. Under this scheme, the senior citizens go to mortgage their house owned by them in reverse to a bank and the bank pays them

the agreed money either in installments or lumpsum. Guidelines for reverse mortgage announced by the National Housing Bank (NHB) in May 2007 has a provision of maximum period of 15 years for such mortgage. Once the period of mortgage is complete either the house should be vacated or the bank will sell the house at the market price and the loan of the bank will be settled. If the value of the house is more than the loan, the difference is paid to the senior citizens or their heirs. If the heir wants to possess the house, he/she needs to pay the loan.

REVERSE YIELD GAP

An excess of returns on gilt-edged (government) securities above those on equities. This occurs during periods of high inflation because equities provide capital gains to compensate inflation while the gilt-edged securities do not.

REVEALED PREFERENCE

The notion that what one wants is revealed by what one does, not by what one says–actions speak louder than words.

RICARDIAN EQUIVALENCE

An idea which (generated too much controversies) originally suggested by David Ricardo (1772–1823) and more recently by Barro, that government deficits do not affect the overall level of demand in an economy.

This is because tax-payers know that any deficit has to be paid later, and so they increase their savings in anticipation of a higher tax bill in future; thus government attempts to stimulate an economy by increasing public spending or cutting taxes, will be rendered impotent by private sector reaction.

The equivalence can be seen as part of a thread of economic thinking which holds that only decisions about real variables (e.g., consumption and production) matter, and that decisions about financing will, in a perfectly functioning market, never have an effect.

RISK SEEKING

An act whereby investors prefer an investment with an uncertain outcome to one with the same expected returns and certainty that it will deliver them – the act which cannot get enough risk.

RULE OF THUMB

A rough-and-ready decision-making aid that provides an acceptably accurate approximate solution to

a problem. Where refined decision-making processes are expensive (in terms of information gathering and processing them), such a method looks justified.

ROUNDING ERROR

The error which comes up due to rounding off the figures in decimals, for example, considering 3.6 as 4 and 3.4 as 3. Such rounding off the data is never going to be mathematically correct.

SALARY

The payment made to employees of an organisation, firm, etc., for the use of labour as a factor of production. It differs from *wage* in the following two ways:

(i) It is not paid on hourly basis (or for the actual number of hours worked by the employee) as wages are paid, and

(ii) It is usually paid on monthly basis whereas wages are paid on daily or weekly basis.

SATISFICING THEORY

A theory which suggests that firms do not want only 'satisfactory' profits but maximum profits as well as other objectives such as sales increase, size increase, etc. might be having equal or greater importance than profits.

SAY'S LAW

Named after the French economist Jean Baptise Say (1767–1832), the law proposes that aggregate supply creates its own aggregate demand.

The logic of the law goes like this–the very act of production generates an income (in the form of wages, salaries, profits, etc.) exactly equal to the output which if spent is just sufficient to purchase the whole output produced. Ultimately, it gives an important clue, i.e., in order to reach full-employment level all that is needed is to increase the aggregate supply.

The key assumption behind the law is that the economic system is 'supply-led' and that all income is spent. But in practice, some income 'leaks' into saving, taxation, etc., and there is no auto-guarantee that all income is 'injected' back as spending. This is why others suggest for a 'demand-led' idea of the economic system under which demand creation is attended vigorously.

SECOND-BEST THEORY

The idea was put forward by Richard Lipsey and Kelvin Lancaster (1924–99) in 1956 which suggests a way out of the situation when all the assumptions of an economic model are not met. As per the theory, the second-best situation is meeting as many of the assumptions as possible (but it might not give the optimum or the desired results).

SECURITIES TRANSACTION TAX

[See Chapter 17 *Tax Structure in India*]

SEIGNORAGE

A method of generating resource by a government through printing of fresh notes/currency notes. Money printing at higher rate to pay the government expenditures leads to inflation that enables the government to secure extra resources though that is called 'inflation tax' also.

SEQUESTRATION

The process under which a third party (*the sequestrator*) holds a part of the disputed assets till the dispute is settled.

SHARPE RATIO

The idea of William Forsyth Sharpe (Nobel Economist) which checks whether the rewards from an investment justify the risk. For this Sharpe uses past data of rewards and calculates it using standard deviation. This is why the ratio says nothing about the future performance of the investment.

SHORT SELLING

Selling shares without possessing them. After the prices fell to a certain extent the short-seller covers his position by cheaper shares booking the difference in price as profits. It is also known as *bear operation*. Short-sellers, however, could get caught on the wrong foot if the market reverses the downtrend.

SHUTDOWN PRICE

That lower level of the prices for the product of a firm at which the firm decides to close (*shut*) down – as it has become impossible to recover even the short-run variable cost at the price. Many such

instances we get in the Euro-American economies during the period of the Great Depression (1929).

SIXTH PAY COMMISSION

Almost after every 10 years, the central government appoints a pay commission to revise the salary structure of about 5.5 million central government employees. The pay commission is not a constitutional body unlike the Finance Commission, and therefore, the government can have a lot of leeway about which part of the report to adopt and in what time frame.

The First Pay Commission was constituted in May 1946 and it submitted its report in a year. The abysmal level of salary of the average government employee prompted the establishment of the commission. This may seem surprising, but the appointment of the pay commission was seen as a humane measure–a far cry from today. The average salary of the employees, even after making allowance for the lower living standards of the day, ranged around Rs. 30. The Second Pa y Panel was set up in August 1957, based on the recommendation of the first commission to set up one after 10 years. It was also necessitated by the Partition and the need to restructure the bureaucracy accordingly. It gave its report exactly after two years. The financial impact of the report was about Rs. 39.6 crore.

The Third Pay Commission, set up in April 1970, gave its report in March 1973. The implementation of its proposals did cost the government Rs. 144 crore. The Fourth Commission was constituted in June 1983, and gave its report in three phases within four years. The financial hit on the government was Rs. 1,282 crore. It was the Fifth Pay Commission which really set back the government finances severely. Formed in April 1994, the panel report was acted upon by the government from January 1997. The financial impact of the the fifth pay panel was a whopping Rs. 17,000 crore. If one adds the Rs. 25,000 crore that state governments paid up as salary and pension to their staff, the impact on the country becomes clear. According to a World Bank report the impact of the award of the pay commision on the states was simlar to the Balance of Payments crisis that the Centre faced in 1991. The states had to re-write their fiscal acts considerably.

First, the fifth commission did not suggest the steep hike that the United Front government finally acceded to. It had broadly recommended a 20 per cent rise in salary scale. But the staff unions managed to push it up to 40 per cent from the existing levels.

Recognising the possible fiscal impact of another pay commission, the fifth commission recommended some far-reaching changes in finances. One of the first was a sustained drive to reduce the number of government staff pruning the size of the bureaucracy by at least 30 per cent. It had also asked for introducing a productivity-linked salary structure and other reforms. None of these had been implemented.

However, the carrots have all been implemented. The panel had suggested that for every 100 points rise in DA, the government should merge 50 per cent of the DA with the salaries to revise the pay scales. This was meant to delay the need for another commission but that has not happened.

The best bet against any profligacy by the new commission is the memory of the impact of the last pay commission. The states and Centre have become wiser. So it is on the cards, that there will be no shock like the last time. But just as the last commision led to the enactment of the Fiscal

Responsibility and Budget Management Act, the present could result in scuttling of the act, or at least delaying the goals of achieving a 3 per cent fiscal deficit at the Centre and zero revenue deficit by 2009, by another few years. The proposed commision is, however, in a good position to look at the still rising numbers in the government staff rolls and suggest clear cut policy to check it.

SKIMMING PRICE

A pricing method of charging high profits–adopted by a firm when consumers are not price- sensitive and demand is price-inelastic.

SOCIAL COSTS

The costs borne by the society at large resulting from the economic activities by the firms–pollution being a prominent example.

SOLVENCY MARGIN

The term made news in the 1970s concerning a life insurance company. The only requirement, till then, by a life insurance company was that the value of its assets should not be less than the value of its liabilities. The regulators in many conntries felt that the value of assets should exceed the value of liabilities by a certain margin. This margin which came to be known as *'solvency margin'* became a useful device to force shareholder of a life insurance company either to keep in reserve a certain portion of the profit or to bring in additional capital if there is not sufficient profit to meet unforeseen contigencies. The European Union developed an empirical formula taking recourse to the past experience to determine the quantum of margin required. The IRDA has stipulated that the excess of assets (including capital) over liabilities should not be less than 150 per cent of the solvency margin arrived at by the EU formula.

On March 31, 2006, the total liability of LIC stood at Rs. 4,52,000 crore and its assets valued at Rs. 4,52,000 crore, having a comfortable margin that did not require capital infusion (though the IRDA has suggested to raise its capital by Rs. 7000 crore by 2009).

SOVEREIGN RISK

The risk of a government defaulting on its debt or a loan guaranteed by it (all international loans by the private companies are basically guaranteed by the government of an economy).

SPOT PRICE

The price quoted for anything in a transaction where the payment and delivery is to be done now.

SPREAD

A frequently used term of financial market which is the difference between two items, for example, the spread (i.e, the difference) an underwriter pays for an issue of bonds from a company and the price it charges from the public. Similarly, the returns on two different bonds if they are different; the difference is known as the spread.

STANDARD DEVIATION

It is a statistical technique to measure how far a variable moves over time away from its mean (average) value.

STATES' MARKET BORROWING

The state governments, for years, had few worries when it came to raising money from the market as it was done at the tutelage of the centre. However, with the onset of financial sector reforms, the contours of raising funds from the market both for the states and the Centre have changed. In the early days after the central bank had come into existence, Madras had objected to the Reserve Bank of India being given the mandate to manage public debt for states. State loans used to be underwritten then.

However, that practice was stopped in the 1950s. Since then, major reforms have taken place. Starting from the 1990s, increasingly states as well as the Centre have accessed funds at market-related rates. Now increasingly, the onus will be on the states to manage their borrowing programmes adroitly.

The borrowing requirements of states were decided earlier in consultation with the Planning Commission and the Finance Ministry. The Reserve Bank of India as the banker to states as well as the debt manager handles the floatations. For decades, the borrowings of states or state loans or *tap issues* as they are called used to be on the basis of pre-determined rates. In effect, all states were treated on the same footing when it came to borrowing. Now a part of market borrowings is through the auctions where the rate is determined based on market response with the rest being through the fixed coupon basis.

The Reserve Bank of India used to take into account the borrowing programme of the Central government, liquidity conditions, the cash flow needs of states, future repayment schedules while working out the borrowing programme for states.

A significant change was signalled when the Twelfth Finance Commission recommended the delinking of grants and loans in Plan assistance to states as part of reforms on the borrowing programme front. Earlier, there was a ratio of 70:30 between loans and grants for extending plan

assistance to states.

What this meant was that states could access loans from the Central Government for their plan expenditure. These loans were for long tenures of over 20 years and a relatively higher interest spread.

The government has accepted the Finance Commission's recommendations on doing away with such loans. This would mean greater recourse to the markets by states. Now like the Centre, states will have to decide their annual borrowing programme within the framework of their fiscal responsibility programmes. This is expected to help in fiscal discipline.

The Commission and the RBI want to impose some sort of discipline on states on their debt management. If more market borrowings by states governments are carried out through the auction route, it would mean that well-managed states would stand to gain. They would be in a position to obtain better rates as the market would factor in the fiscal strengths of a particular state when pricing is determined.

When states take a recourse to market borrowings through the auction route, there would be greater price discovery besides enhanced secondary market liquidity for such securities.

A state whose credit rating is strong will get a better rate while borrowing while a weaker state may have to settle for a higher rate. This is expected to lead to greater attention and focus fiscal responsibility and debt management by states especially as they cannot look to the Central Government for loans as in the past. The Reserve Bank of India, which is the debt manager for both the Centre and states, wants to progressively raise the share of market borrowings by states under the auction route so that the entire programme is covered through auctions.

STEALTH TAX

A popular name given to an obscure tax increase as for example stamp duty, property tax etc. Which get implemented months later by the time they usually fade out from the public memory.

STOCHASTIC PROCESS

It is a process that shows random behaviour. As for example, *Brownian* motion which is often used to describe changes in share prices by the experts in an efficient market (random walk), is such a process.

SUB-PRIME CRISIS

The word 'sub-prime' refers to borrowers who do not have sound track record of repayment of loans (*it means such borrowers are not 'prime' thus they could be called as 'less than prime' i.e. 'sub-prime'). The* 'sub-prime crisis' which has been echoing time and again recently has its origin in the United States housing market by take-2007–being considered as the major financial crisis of the new

millenium.

Basically, last few years have seen a gradual softening of international interest rates, relatively easier liquidity conditions across the world motivating the investor (i.e., banks, financial institutions, etc.) to expand their presence in the sub-prime market, too. The risks inherent in sub-prime loans were sliced into different components and packed into a host of securities, referred to as asset-backed securities and *collaterised debt obligations* (CDOs). Credit rating agencies have assigned risk ranks (e.g., AAA, BBB, etc.) to them to facilitate their marketability. Because of the complex nature of these new products, intermediaries (such as hedge funds, pension funds, banks, etc.) who held them in their portfolio or through special purpose vehicle (SPVs), were not fully aware of the risks involved. When interest rates rose leading to defaults in the housing sector, the value of the underlying loans declined along with the price of these products. As a result institutions were saddled with illiquid and value-eroded instruments, leading to liquidity crunch. This crisis of the capital market subsequently spread to money market as well.

The policy response in the US and the Euro area has been to address the issue of enhancing liquidity as well as to restore the faith in the financial system. The sub-prime crisis has also impacted the emerging economies, depending on their exposure to the sub-prime and related assets.

India has remained relatively insulated from this crisis. The banks and financial institutions in India do not have marked exposure to the sub-prime and related assets in matured markets. Further, India's gradual approach to the financial sector reforms process, with the building of appropriate safeguards to ensure stability, has played a positive role in keeping India immune from such shocks.

SUBSIDIES

Are subsidies negative taxes? Are they converse of indirect taxes? What are subsidies and why are they important? These are some questions which always make rounds every time the Union Budgets are presented. *Subsidies include all grants on current account made by the government to depress the price of any good or service below its economic cost.* Often subsidies are grants made by public authorities to government enterprises in compensation of operating losses when these losses are clearly the consequences of the policy of the government to maintain prices at a level below costs of production. The regime of subsidies is, therefore, a *political economic policy* framework typical of welfare states (India is one). Various subsidy regimes are meant to ensure distributive justice. Subsidies are directed at various sections of society to assist them economically. In India, the main beneficiaries have been farmers, needy people and those using various forms of public services, social services and economic services. The first includes fiscal and administrative services like justice, jails and police, which are in the nature of pure public goods. The last two categories include a range of goods and services, which are not purely public and where the users identifiable and user charges can be levied. For example, roads and power. Governments make such goods and services available to users at costs lower than what was expended to produce and/or provide them because social benefits of doing so exceed the aggregate of private benefits to individual consumers. For instance, compulsory and free elementary education, a subsidy provided by the government, aids the social development and uplift of the poor and socially depressed classed by making such education easily accessible to them. Subsidies are financed either from tax or non-tax revenue, or result in a

deficit.

Broadly speaking and purely at the level of the central government, there are three major types of subsidies–food subsidies (for farmers and the poor who avail the public distribution system), fertiliser subsidies (for farmers), and petroleum subsidies (for the poor and the middle class, on Kerosene and LPG, which they directly consume; or diesel which fuels the transport industry that carries essential goods and thus has an impact on their prices). These are clearly visible in the government's budget document. Apart from these, there are also *minor subsidies* such as on interest rates and subsidies hidden in the provision of social and economic services–mainly healthcare and education. In social services, the Centre's participation is limited. Most of the social sector expenditure pertains either to the Union Territories that figure in the Union budget, or are in the nature of departmental transfers to state governments.

The regime of subsidies has been a contentious issue of higher order in India. The benefits from subsidies can be maximised only when they are transparent, well targeted, and suitably designed for effective implementation without any leakages. Various studies have shown how the proliferation of subsidies in India is an outcome of undue expansion of government activities in the provision of goods and services that are not pure public goods. Subsidies result from the government's inability to recover its costs adequately in many of these activities. Critics have blamed this on the ill-considered use of subsidies by political parties for electoral ends and have been arguing for reduction of some subsidies and the phasing out of others. Those who support the continuing of subsidies, however, argue that the focus on reducing subsidies only comes about because of the government's failure to raise tax revenues.

SUBSIDY BIDDING

It is competitive bidding for subsidies, where companies bid against one another to serve an area at the lowest price–the lure is the subsidy and other benefits. This system is a way of administrating subsidies without leaving any room for some competitors or technologies gaining an edge over others. But competitive bidding has anticompetitive effects, since it gives a special advantage to one company. Regulators should adopt a consumer choice system, under which any subsidy for each high cost customer it served. If the customer moved to a competing carrier, the subsidy would move, too.

SUBSTITUTION EFFECT

The replacement of one product for another resulting from a change in their relative prices.

SUNK COSTS

The costs in commercial activities that have been incurred and cannot be reversed. The cost on advertisement, research and development, etc. are examples of such costs. Sunk costs are a big deterrant to new entrants in the commercial world as after the venture has failed these costs cannot be

recovered–there is no two-way process here.

SWAP

The act of exchanging one by another. It could be of many economic items:

Currency Swap

The simultanous buying and selling of foreign currencies could be *spot* or *forward/future* currency swaps. This is used by MNCs to minimise the risk of losses arising from exchange rate changes.

Debt swap

Exchanging one debt by another for a fresh term of repayment schedule at the same or usually lower interest rates.

Interest Rate Swap

Exchanging one debt of a particular interest rate for another at lower interest rate.

Product Swap

Exchanging one product for the other as wheat for milk (similar to barter).

SWFS

Sovereign wealth funds (SWFs) are the foreign currency funds held by the governments of the world, specially in Asia and West Asia. After the process of globalisation, freer capital movements to the developing economies had brought enough foreign currencies to some economies. Earlier, such funds used to originate in Singapore and Norway but now we see China, Russia, and the Middle East emerging as the new SWFs economies.

Such funds, estimated to be sitting on a total of $25 trillion, are eagerly looking to diversify into higher yielding riskier assets. Any fast growing economy with open and liberal attitudes to foreign investments with opportunities for investment may face up the inflow of such funds. India is one fit candidate today.

Such funds need to be studied and alllowed entry cautiously as they bring in non-market and extraneous factors with them too, having potential diplomatic, strategic and sovereign dangers to the host economies. In November 2007, the National Security Advisor of India voiced apprehension about such funds.

SWISS FORMULA

Tariff cut formulae are either linear or non-linear. A Swiss formula is a non-linear formula. In a linear formula, tariffs are reduced by the same percentage irrespective of how high the initial tariff is. As opposed to a linear formula, in a non-linear formula, tariff cuts are directly or inversely proportional to the initial tariff rate.

In the Swiss formula, tariff cuts are proportionally higher for tariffs which are initially higher. For instance, a country which has an initial tariff of 30 per cent on a product will have to undertake proportionally higher cuts than a country which has an initial tariff of 20 per cent on the same product.

In the on-going multilateral trade negotiations at the World Trade Organisation (WTO), it has been decided by all participating countries to use the Swiss formula for reducing import tariffs on industrial goods. After a long-standing debate on the number of reduction coefficients to be used in the formula, a unanimous decision was recently taken that there would be two sets of coefficients–one for the developed countries and another for developing countries. A decision on the value of the coefficient is yet to be taken.

India's average tariffs are much higher than those existing in the developed countries. If a linear formula for tariff reduction was used, then its reduction burden would have been proportional to that of developed countries. However, using a Swiss formula could lead India to taking on a greater reduction commitment than its developed counterparts with lower initial tariffs.

India agreed to a Swiss formula because it was decided that developing countries would be allowed to have a higher reduction coefficient than developed countries which could lower their tariff reduction obligations.

A reduction coefficient is part of the Swiss formula. It has a very important role to play in deciding the final reduction commitment. If all other variables in the Swiss formula remain unchanged, then a higher reduction coefficient could lead to lower reduction commitment and vice versa.

India wants that the reduction coefficient for developing countries should be much higher than the coefficient for developed countries. The difference should be enough to negate the effect of the original Swiss formula which weighs in favour of developed countries with lower initial tariffs. It has proposed that a difference between the coefficients should be at least 25 points to ensure that the reduction burden on developing countries is not higher than that on developed countries.

SYSTEMIC RISK

The risk of damage to the health of the whole financial system. In modern financial world, the collapse of one bank could bring down the whole financial system.

TAKEOVER

The process of one firm acquiring the other, also known as *acquisition*. As opposed to the merger which is an outcome of 'mutual agreement', takeovers are 'hostile' moves.

Takeovers may be classified into three broad categories:

(i) *Horizontal takeovers* involve firms which are direct competitors in the same market;

(ii) *Vertical takeovers* involve the firms having supplier-customer relationship; and

(iii) *Conglomerate takeovers* involve the firms operating in unrelated markets but intend diversification.

TAKEOVER BID

An attempt of acquiring the majority share in a firm by another firm. There are various *terms* to show the *'tactics'* applied in such bids either by the bidder or the bidded firms:

Black Knight

The launch of an unwelcome takeover bid (as the Mittal's for the Arcelor in recent past).

Golden Parachute

A generous severance term written into the employment contracts of the directors (of a firm) which makes it expensive to sack them if the firm is taken over.

Green Mail

A situation of takeover bid when the bought-up shares by a potential bidder is actually being bought by the directors of the firm itself.

Leveraged Bid

A takeover bid being financed primarily by the loan.

Pac-man Defence

A situation when the firm being bidded for takeover, bids for the bidder firm itself–also known as *reverse takeover bid.*

Poison Pill

A tactic used by the firm being bidded of merging with some other firm in order to make itself less attractive (financially or structurally) to the potential bidder.

Porcupine

Any agreements between the firm being bidded and its suppliers, creditors, etc. which are so complex that after the takeover the bidder firm feels diffculties integrating it.

Shark Repellants

The measures specially designed to discourage takeover bidders (e.g., altering the firm's articles of association to increase the proportion of shareholder votes needed to approve the bid above the usual 50 per cent level, etc.).

White Knight

The intervention of a third firm in a takeover bid which either merges or takes over the victim firm to rescue it from the unwelcome bidder.

TECHNOLOGICAL UNEMPLOYMENT

Unemployment which results from the automation of the production activities (*i.e., machines replacing men*).

THIRD-PARTY INSURANCE

Motor third-party insurance or third-party insurance is a statutory requirement under the Motor Vehicle Act in India–also known as *'act only'* cover. A person purchasing a motor vehicle has to go for this compulsory insurance which benefits the third person (i.e. neither the vehicle owner nor the insurance company)–the person who becomes victim of an accident by the vehicle.

Till December 31, 2005, the premium for the insurance was fixed by the Tariff Advisory Committee (an arm of the IRDA) but since then it has been done away with. However, IRDA still continues to fix the premium for the mandatory third-party insurance, though the insurance companies have the freedom to decide on prices for comprehensive cover.

The amount of compensation is largely decided by the earning capacity of the accident victim.

THIRD WAY

An economic philosophy (better say rhetoric) which propagates it is neither capitalism nor socialism but a third (pragmatic) way.

The idea was popularised in the late 20th century by some political leaders having leftist leanings, including Bill Clinton and Tony Blair. Though it has been hard to pin down it was earlier used to describe the economic model of Sweden.

TIGHT MONEY

When money has become difficult to mobilise–the term is used to show the 'dear money' when the rates of interest run comparatively on the higher side.

TILL MONEY

The notes and coins the commercial banks keep to meet everyday cash requirements of their customers (this is counted as part of their CRR).

TOBIN TAX

A prosposal of imposing small tax on all foreign exchange transactions with the obejctive to discourage destabilising speculation and volatility in the foreign exchange markets.

Proposed by the Nobel prize-winning economist James Tobin (1918–2002), the tax has never been implemented anywhere in the world so far.

TOTAL PRODUCT

The main/core product supported by many peripheral products/services, as for example a car, coming with loan facility, warranties, insurance, and after sale service, etc.

TRADE CREATION

The increase in international trade that results from the elimination or reduction of trade barriers (such as quota, customs, etc.).

TRAGEDY OF THE COMMONS

Refers to the dangers of over-exploitation of resources due to lack of property rights over them (‘commons’ are the resources neither owned privately nor by the state but are open for free use by all). A rationing or imposing of levy on such resources as a check.

The concept was proposed by a 19th-century amateur mathematician William Forster Lloyd.

TRANSFER PAYMENTS

The expenditure by the government for which it receives no goods or services. For example, the expenditures on tax collection, social sector, unemployment allowance, etc.

As such expenditures are not done against any products they are not counted in the national income of the economy.

TRANSFER EARNINGS

The return that an asset must earn to prevent its transfer to the next best alternative use. Any earning above the transfer earnings is known as its *'economic rent'*.

TRANSFER PRICE

A term of international economics via which an MNC charges lesser prices for its exportables to its arm in another economy where tax rates are high, for increasing income. The East India Company did it heavily in pre-independent India.

ULIPS & MFS

Unit linked insurance policies (ULIPs) offer insurance plus investment objective to those who want a higher amount of insurance cover at a marginally higher cost. However, unlike mutual funds, which may be a short-term investment play, ULIPs meet long-term investment objectives. Essentially, ULIPs must be treated as long-term (15-plus years) investment vehicles.

Returns are varied across the risk class. One can categorise risks into three classes for both MF and ULIP schemes–high, medium, and low risks. High-risk policies have a higher exposure to equities and low-risk policies might have low or no exposure to equities. For MFs, high-risk comparable products are diversified equity funds, medium-risks are balanced funds, and low risks are debt instruments.

UNDERWRITING

The process of acceptance by a financial institution of the financial risks of a transaction for a fee. For example, merchant banks underwrite new share issues, guaranteeing to buy up the shares not sold in a public offer (i.e., in the situations of under-subscription).

USURY

Charging an exorbitant rate of interest or even charging interest. Decried by many ancient philosophers and many religions, today most modern economies have some law regulating the upper limit of the interest rates and they consider interest as a reward to the lender for the lending risk.

VEBLEN EFFECT

Named after the American economist Thorstein Bunde Veblen (1857–1929), this is a theory of consumption which suggests that consumers may have an 'upward-sloping demand curve' as opposed to a 'downward-sloping demand curve' because they practice conspicuous consumption (*a downward - sloping demand curve means that the quantity demanded varies inversely to the price i.e. demand falls with price rise*). The concept suggests that quantity demanded of a particular good varies directly with a change in price (*i.e., as price increases, demand increases*).

VELOCITY OF CIRCULATION

A measure of the average number of times each unit of money is used, to purchase the final goods and services produced in an economy in a year.

VENTURE CAPITAL

Generally, a private equity capital which lends capital to the entrepreneurs who are innovative and cannot get the required fund from the conventional set-up of the lending mechanism.

In India, it was the Government of India which did set up the first such fund in 1998–the IVCF.

VULTURE FUNDS

Vulture funds are privately owned financial firms which buy up sovereign debt issued by poor countries at a fraction of its value, then file lawsuits (sue) against the countries in courts, usually in London, New York, or Paris, for their full face value plus interest.

A paper prepared for IMF/WB (October 18, 2007) showed that there are now $1.8b lawsuits against poor countries where people typically live below $1 a day; 24 countries that have received debt cancellation under Heavily Indebted Poor Countries (HIPCs)initiative, 11 have been targeted by such creditors (i.e., the VFs) and they has been awarded just under $1b.–money which have gone for schools and hospitals; they are neutralising the good deeds of WB/IMF. As per the IMF, the litigating creditors were concentrated in the US, UK as well as the British Virgin Islands (BVI)–the UK protectorate tax haven. Bush is being pressed by a motion signed by 110 MPs to change the law which allows them to file cases in US courts–VFs contradict US foreign policy.

VOSTRO ACCOUNT

Vostro is an account that one party holds for another. With a view to give more operational leeway, the RBI decided to dispense with the requirement of prior approval of the RBI for opening and maintaining each rupee **vostro account** in India of non-resident exchange houses in connection with the rupee drawing arrangements (RDAs) that banks enter into with them. The approved dealer banks could now take its permission the first time they entered into such an arrangement with non-

resident exchange houses from the Gulf countries, Hong Kong, Singapore and Malaysia. Subsequently, they may enter into RDAs, and inform the RBI immediately.

WALRAS'S LAW

The idea that the total value of goods demanded in an economy is always identically equal to the total value of goods supplied.

This could be only correct in a barter economy not in an economy which uses currency as the mode of exchange.

WASTING ASSET

The natural resource which has a finite but indeterminate life span depending upon the rate of depletion (such as coal, oil, etc.).

WEIGHTLESS ECONOMY

The situation of an economy when the output is increasingly produced from intellectual capital rather than physical materials–a shift in production from iron and steel, heavy machines, etc. to microprocessors, fibre optics and transistors, etc. This is the weightless economy i.e., the *new economy* which arrived in the US (specially) by the end of the 20th century.

WELFARE ECONOMICS

The branch of economics which is concerned with the way economic activity ought to be organised so as to maximise economic welfare. The idea applies to the welfare of individuals as well as countries.

This is normative economics, i.e., it is based on value judgements. It is also called *'economics with a heart'*. This focuses on questions about *equity* as well as *efficiency*.

It employs value judgements about what *ought* to be produced, how production *should* be organised, the way income and wealth *ought* to be distributed, both in present times and in future. As different individuals in different communities have unique set of value judgements (guided by their attitutdes, religion, philosophy, and politics) it has been difficult for the economists to reach a consensual idea upon which they could advise the governments in policy making, known as the *welfare criteria*. Economists and philosophers have been suggesting their brands of the *welfare criteria* since long–Vilfredo Pareto, Nicholas Kaldor, John Hicks, Scitovsky, Amartya Sen, as the few famous ones.

WILDCAT STRIKE

A strike called on by a group of employees without the support of their organised trade union.

WILLIAMSON TRADE-OFF MODEL

A model for evaluating the possible benefits and detriments of a proposed merger that could be used in the application of a discretionary competition policy. The model was developed by Oliver Williamson.

WINNER'S CURSE

The possibility that the winning bidder in an auction will pay too much for an asset since the highest bidder places a higher value on the asset than all other bidders.

WITHHOLDING TAX

A tax imposed on the income on a foreign portfolio (investments). This tax is imposed to discourage foreign investments, to encourage domestic investment, and to raise money for the government.

WORKER (CENSUS DEFINITION)

The *first* definition of 'worker' by *Census* was given in 1872. Over time the term 'work' and 'worker' as defined by ***Census of India*** have undergone several amendments to suit the changing dimensions of work. 'Work' is defined as participation in any *economically productive activity* with or without compensation, wages or profit. Such participation may be physical and/or mental in nature. Work involves not only actual work but also includes –

(i) Effective supervision and direction of work;

(ii) Part time help or unpaid work on farm, family enterprise or in any other economic activity; and

(iii) Cultivation or milk production even solely for domestic consumption.

Accordingly, as per Census of India, all persons engaged in 'work' defined as participation in any economically productive activity with or without compensation, wages or profit are workers. The Reference period for determining a person as worker and non-worker is one year preceding the date of enumeration.

The Census *classifies* 'Workers' into two groups namely, *Main Workers* (those workers who had worked for the major part of the reference period, i.e., 6 months or more) and *Marginal Workers* (those workers who had not worked for the major part of the reference period i.e. less than 6 months). The *Main* workers are classified on the basis of Industrial category of workers into the following four categories: (i) Cultivators; (ii) Agricultural Labourers; (iii) Household Industry Workers; and

(iv) Other Workers.

[See entry *'Non-Worker'* also.]

WORKER POPULATION RATIO

The employment-to-population ratio is defined as the proportion of an economy's working-age population that is employed. As an indicator, the employment-to-population ratio provides information on the ability of an economy to create jobs. Worker population ratio (WPR) is defined as the number of persons employed per thousand persons [WPR= No. of employed persons X 1000/Total population]. Worker Population Ratio is an indicator used for analyzing the employment situation in the country. This is also useful in knowing the proportion of population that is actively contributing to the production of goods and services in the economy.

[*Reference:* NSSO (2005), *Report No. 515, Employment Unemployment Situation in India (Part 1), 61st Round (2004-2005)*]

WORKFARE

Government programmes which make the receipt of unemployment-related benefits (as unemployment allowance) conditional upon participation in some local work scheme.

X-INEFFICIENCY

A graphic representation of the 'gap' a firm shows in its actual and minimum costs of supplying its products. As per the traditional theory of supply, firms always operate on minimum attainable costs. As opposed to this, X-inefficiency suggests that firms typically operate at higher costs than their minimum attainable costs. This takes place due to many *inefficiencies* (such as organising the works, lack of co-ordination, lack of motivation, bureacratic rigidities etc.). Large corporates usually face this problem as they lack effective competition which could 'keep them on their toes'.

YIELD GAP

A method of comparing the performance of bonds and shares in an economy. It is defined as the average returns on shares minus the average returns on bonds.

ZERO-COUPON BOND

A bond bearing zero coupon rate (i.e. no interest) sold at a price lower than its face value and

investors getting the face value price at maturity.

ZERO-SUM GAME

A situation in the *game theory* when the gains made by winners in an economic transaction is equal to the losses suffered by the losers. This is considered a special case in game theory. Most economic transactions are in some sense *positive-sum games*. But in popular discussion of economic issues, there are often examples of mistaken zero-sum mentality, such as profit comes at the expense of wages, 'higher productivity means fewer jobs', and 'imports mean fewer jobs here.'

ZERO TILLING

A relatively new farm production process, is a one-time operation in which a small drill places the seed and the fertiliser in a small furrow, saving the farmer a lot of time and other resources. At first utilised in Haryana in 1999–2000, by now it has spread to the other wheat growing states like, Punjab, Uttar Pradesh, Uttarakhand, and Bihar particularly. The technique gives comparatively higher yield (by over 5 per cent) than the conventional wheat farming.

Note: The concepts of economics as well as the Indian economics have been prepared after consulting some basic sources on the areas which are as follows (for publication details see the other chapters of this book): ***Economics*** by Samuelson and Nordhaus; ***Economics*** by Stiglitz and Walsh; ***Economics*** by P. Dasgupta (Oxford); ***A History of Economics*** by J.K. Galbraith; ***Economic Development*** by Smith and Todaro; ***Leading Issues in Economic Development*** by Meier and Rauch; ***International Economics*** by Salvatore; ***Comparative Economics in a Transforming World Economy*** by Rosser and Rosser; ***Collins Internet-linked Dictionary of Economics*** by Christopher Pass, et.al.; ***Oxford Dictionary of Economics*** by John Black; ***Penguin Dictionary of Economics*** by G. Bannock et.al.; ***Oxford Dictionary of Business*** by J. Pallister and A. Isaacs (eds.); ***Economics*** by S. Cox, The Economist; ***Pocket Economics*** by M. Bishop, The Economist; ***Pocket Finance*** by Tim Hindle, the Economist; ***Pocket International Business Terms*** by T. Hindle, The Economist; ***The End of Poverty*** by J. Sachs; ***The World is Flat*** by Thomas L. Friedman; ***The Undercover Economist*** by Tim Harford; ***Freakonomics*** by Levitt and Dubner; ***Book of Financial Terms*** by Sundararajan; ***Guide to Financial Markets*** by Marc Levinson; ***The Stock Market Dictionary*** by P.N. Shroff; ***Stock Exchanges and Investments*** by Raghunathan; ***India Development Report***, Oxford, (various issues); ***Economic Survey***, GoI (various issues); ***India***, GoI (various issues). as well as various issues of Economist, Time (Asia Edition), Financial Times (London), News Week, Business Week (USA), Financial Express (N. Delhi), Business Line (N. Delhi) and Economic Times (N.Delhi).

ECONOMIC SURVEY 2012-13

- An Introduction
- Summary of the Survey
- Aspects of Growth
- Industry and Infrastructure

AN INTRODUCTION

This is for the first time, probably, that the Economic Survey includes 'an introduction' to it. credit goes to Raghuram G. Rajan, Chief Economic Adviser, Ministry of Finance.

There are ***three objectives*** for India that are echoed through much of the Economic Survey.

1. First, India has to revive growth, and that growth has to provide more decent jobs for the many millions who will join the labor force, even while reducing poverty .
2. Second, India needs to shift from consumption to investment, that is, increase our savings especially government savings and household financial savings, even as we also increase corporate and infrastructure investment.
3. Third, India needs macroeconomic stabilisation to bring down inflation, the fiscal deficit and the current account deficit.

There are similarities between some of these objectives, as also apparent tensions. For example, rebalancing towards *investment* can potentially raise growth as well as alleviate supply constraints, reduce inflation, and thus achieve macro stabilisation. On the other hand, *fiscal consolidation* is often thought to be detrimental to growth in the short-run. However, this tension may only be apparent. Macroeconomic rigour may, in fact, lead to growth; cutting wasteful subsidies may reduce market distortions, shrink excess consumption, and increase confidence about government finances, all of which can help growth, even in the short-run.

The Survey cites a number of factors responsible for the ***recent slowdown*** –

i. First, the boost to demand given by monetary and fiscal stimulus following the global financial crisis was large, even though the economy was already reaching the limits to its potential growth before the crisis. The resulting recovery from the crisis was strong and final consumption grew at an average of over 8 percent annually between 2009-10 and 2011-12. One consequence was strong inflation, and a powerful monetary response that also slowed consumption demand.

ii. Second, starting in 2011-12, corporate and infrastructure investment started slowing both as a result of policy bottlenecks as well as the tighter monetary policy.

   Unfortunately, even as the economy slowed, it was hit by ***two additional shocks***:

iii. A slowing global economy, weighed down by the crisis in the Euro area and uncertainties about fiscal policy in the United States, and

iv. A weak monsoon, at least in its initial phase.

As growth slowed and government revenues did not keep pace with spending, the **fiscal deficit** threatened to breach the target. With government savings falling, and private savings also shrinking, the current account deficit which is the investment that cannot be financed by domestic savings and has to be financed from abroad also widened. As per the Survey, these are difficult times, but India has navigated such times before, and with good policies it will come through stronger. For the Survey **the way outlies** in –

1. shifting national spending from consumption to investment, removing the bottlenecks to investment, growth, and job creation, in part through structural reforms,

2. combating inflation both through monetary and supply side measures,
3. Reducing the costs for borrowers of raising financing and increasing the opportunities for savers to get strong real investment returns.

Every recent Survey has had a special focus on jobs. Policymakers are usually attentive to short-run economic management issues. But the short run has to be a bridge to the long run. The central long - run question facing India is – ***where will good jobs come from?*** Productive jobs are vital for growth. And a good job is the best form of inclusion. More than half our population depends on *agriculture*, but the experience of other countries suggests that the number of people dependent on agriculture will have to shrink if per capita incomes in agriculture are to go up substantially. While industry is creating jobs, too many such jobs are low-productivity informal and non-regular jobs in the unorganised sector, offering low incomes, little protection or benefits. Services jobs are relatively high productivity, but conditions for faster growth of productive jobs outside of agriculture, especially in organised manufacturing and in services, even while improving productivity in agriculture. The Survey ***calls for reforms***, including the expansion of infrastructure, better and more effective regulation, and improvements in access to land and finance that would encourage the entry and growth of business enterprises. The Survey suggests that unless India undertakes these reforms, it will grow far below potential, and risks fiscal strains and social unrest as more and more people fall behind.

The Survey is both an analytical document, as it tries to understand the current conjuncture in suggesting policy measures as well as a document recording data and government activities. It is both backward looking as well as forward looking. *And it is of the government since most of the authors are government servants, but also distanced from the government as it is meant to take a dispassionate view of the government's record over the past year and its policies going forward. These aspects of the Survey do not all sit easily together, nevertheless the authors of the survey manage the trade-offs every year*. I hope you get as much out of it as I did.

SUMMARY OF THE SURVEY

GROWTH AND OTHER MACRO AGGREGATES

While India's recent slowdown is partly rooted in external causes, domestic causes are also important. The strong post-financial-crisis stimulus led to stronger growth in 2009-10 and 2010-11. However, the boost to consumption, coupled with supplyside constraints, led to higher inflation. Monetary policy was tightened, even as external headwinds to growth increased. The consequent slowdown, especially in 2012-13, has been across the board, with no sector of the economy unaffected. Falling savings without a commensurate fall in aggregate investment have led to a widening current account deficit (CAD). Wholesale price index (WPI) inflation has been coming down in recent months. However, food inflation, after a brief slowdown, continues to be higher than overall inflation. Given the higher weightage to food in consumer price indices (CPI), CPI inflation has remained close to double digits. Another consequence of the slowdown has been lower-than-targeted tax and non-tax revenues. With the subsidies bill, particularly that of petroleum products, increasing, the danger that fiscal targets would be breached substantially

became very real in the current year. The situation warranted urgent steps to reduce government spending so as to contain inflation. Also required were steps to facilitate corporate and infrastructure investment so as to ease supply. Several measures announced in recent months are aimed at restoring the fiscal health of the government and shrinking the CAD as also improving the growth rate. With the global economy also likely to recover somewhat in 2013, these measures should help in improving the Indian economy's outlook for 2013-14.

Following the slowdown induced by the global financial crisis in 2008-09, the Indian economy responded strongly to fiscal and monetary stimulus and achieved a growth rate of 8.6 per cent and 9.3 per cent respectively in 2009-10 and 2010-11. However, with the economy exhibiting inflationary tendencies, the Reserve Bank of India (RBI) started raising policy rates in March 2010. High rates as well as policy constraints adversely impacted investment, and in the subsequent two years viz. 2011-12 and 2012-13, the growth rate slowed to 6.2 per cent and 5.0 per cent respectively. Nevertheless, despite this slowdown, the compound annual growth rate (CAGR) for gross domestic product (GDP) at factor cost, over the decade ending 2012-13 is **7.9** per cent.

The moderation in growth is primarily attributable to weakness in **industry** (comprising the mining and quarrying, manufacturing, electricity, gas and water supply, and construction sectors), which registered a growth rate of only 3.5 per cent and 3.1 per cent in 2011-12 and 2012-13 respectively. The rate of growth of the manufacturing sector was even lower at 2.7 per cent and 1.9 per cent for these two years respectively. Growth in agriculture has also been weak in 2012-13, following lower-than-normal rainfall, especially in the initial phases (months of June and July) of the south-west monsoon.

After achieving double-digit growth continuously for five years and narrowly missing double digits in the sixth (between 2005-06 and 2010-11), the growth rate of the **services** sector also declined to 8.2 per cent in 2011-12 and 6.6 per cent in 2012-13. In 2011-12 the sector that particularly slowed within the services sector was Trade, Hotels, and Restaurants, Transport and Communications, and its growth further declined in 2012-13. Activities in this sector, being forms of derived demand, tend to grow at a slower rate with the slowdown of economic activity in the industry and agriculture sectors.

Why has the economy slowed down so rapidly despite recovering strongly from the global financial crisis? A number of factors are responsible for this as per the ***Survey*** –

i. The boost to demand given by monetary and fiscal stimulus following the crisis was large. Final consumption grew at an average of over 8 per cent annually between 2009-10 and 2011-12. The result was strong inflation and a powerful monetary response that also slowed consumption demand.

ii. Starting in 2011-12, corporate and infrastructure investment started slowing both as a result of investment bottlenecks as well as the tighter monetary policy.

iii. Even as the economy slowed, it was hit by two additional shocks: a slowing global economy, weighed down by the crisis in the Euro area and uncertainties about fiscal policy in the United States, and a weak monsoon, at least in its initial phase.

As growth slowed and government revenues did not keep pace with spending, the fiscal deficit threatened to breach the target. With government savings falling, and private savings also shrinking, the current account deficit (CAD), which is the investment that cannot be financed by domestic

savings and has to be financed from abroad also widened.

ASPECTS OF GROWTH

In the last decade, growth has increasingly come from the ***services sector***, whose contribution to overall growth of the economy has been **65** per cent, while that of the ***industry*** and ***agriculture*** sectors has been **27** per cent and **8** per cent, respectively.

For achieving an annual growth rate of 9 per cent or higher, all the three major sectors of the economy have to perform well. Growth in agriculture, while small in overall contribution, does distinguish years of strong overall growth from years of more moderate growth. The two larger sectors are, of course, important to overall growth. In the high growth years of 2005-06 to 2007-08 as well as in 2009-10 and 2010-11, the rate of growth of both the industry and services sectors was over 9 per cent. Within the industry sector, the manufacturing sector in particular, outperformed most other sectors of the economy in these years. Its growth averaged 11.6 per cent between 2005-06 and 2007-08 and 10.5 per cent for the years 2009-10 and 2010-11. It is clear from the foregoing analysis that for growth to be strong, the contribution from the industry sector, and in particular from the manufacturing sector, has to increase in the years to come. This is also important from the point of view of absorbing surplus labour from the agriculture sector.

The general pattern over recent years has been that, in years of sharply higher growth, GDP growth at market prices exceeds GDP at factor cost and the reverse is true in years of slow growth. *GDP at factor cost is GDP at market prices less indirect taxes plus subsidies.* Part of the reason for the differences in growth at factor costs and at market prices lies in the fact that the growth of indirect taxes tends to fall in a slowdown while the expenditure on subsidies often increases. This reduces the growth of net indirect taxes, which is the difference between the two items, in a slowdown.

The rate of growth in terms of GDP at market prices (at 2004-05 prices, i.e. is the Base Year) is expected to be 3.3 per cent for 2012-13 as against 6.3 per cent in 2011-12 (as per the Advance Estimates of the CSO). The growth rate declined significantly on account of the reduction in investment rate and lower growth of exports vis-à-vis that of imports. The rate of growth of consumption expenditure and particularly that of private final consumption expenditure has generally been more stable than investment, except in 2012-13.

Private Final Consumption Expenditure

Private final **consumption expenditure** accounts for about *three-fifths* of GDP at market prices. An "increase in people's disposable income tends to reduce the share of food in total consumption" [the National Sample Survey Organisation's (NSSO) Survey on Consumption. Expenditure provides clear evidence of the downward trend in share of food in total consumption]. As expected, therefore, the growth rate of expenditure on the food, beverages, and tobacco group is lower than that of total private final consumption expenditure, resulting in a reduction in its share from 40 per cent in 2004-05 to 31.2 per cent in 2011-12.

In the current year, private final consumption expenditure has slowed considerably, from 8 per cent in 2011-12 to 4.1 per cent in 2012-13. The rate of growth of production of a large number of consumer

durables declined significantly, e.g. private vehicles from 23.2 per cent in April-November 2011 to -5.6 per cent in April-November 2012. Similarly, the growth rate of production of consumer durables for mass consumption declined from 12.2 per cent in April-November 2011 to 3.3 per cent in April-November 2012.

Part of **the reason** for the general slowdown in consumption could be that higher inflation tends to reduce real disposable incomes of households. Growth of durable goods consumption (under the assumption that growth of consumption for these items would not be significantly different from the growth in production) may have slowed even further recently, because high interest rates and resulting high monthly instalments restrained purchases. At the same time, the seasonally adjusted consumer non-durable index of industrial production (IIP), which is typically a smoother series than durable goods production, has been picking up since August 2012.

Investment

The growth rate of the economy since 2003-04 has been strongly correlated with investment rate.The investment rate averaged **34.5** per cent between 2003-04 and 2011-12, much higher rate than before. The real growth rate in the economy averaged 9.5 per cent per annum during 2005-06 to 2007-08, which were also the years when the ***growth rate of investment*** in real terms averaged around 16 per cent. Similarly, the average growth rate of the economy was close to 9 per cent per annum in 2009-10 and 2010-11, with the growth rate of investment averaging around 16.2 per cent in these two years. The rate of growth of GDP was lower in the years when growth rate of investment was low, as was the case in 2008-09 and 2011-12. The private sector is the major source of investment in the country. Within the private sector there are two categories of investors, viz. the private corporate sector and household sector.

As per the First Revised Estimates released by the CSO in January 2013, gross domestic capital formation as a ratio of GDP at current market prices (investment rate) is estimated to be **35.0** per cent in 2011-12 as against 36.8 per cent in 2010-11. Both public and private investment declined as a share of GDP. Within private investment, investment by the private corporate sector registered a sharper decline.

The ***reduction in private investment*** could be attributed to a number of factors.

i. First is the increase in policy rates (to combat inflation and inflationary expectations). Between March 2010 and October 2011, the RBI raised the repo rate by 375 basis points (bps),thus raising the cost of borrowings in a bid to reduce demand.

ii. Another reason for lower private investment could be lower demand for Indian exports from the rest of the world, particularly the advanced countries.

iii. A third possible reason for lower corporate investment is policy bottlenecks (such as obtaining environmental permissions, fuel linkages, or carrying out land acquisition), which led to a number of large projects becoming stalled, which may in turn have discouraged new investment.

Recent Investment Trends

Two trends in investments stand out viz., rising stalled projects and falling project starts. To study these, the Survey uses the data from the ***CaPex*** database of the Centre for Monitoring Indian Economy (CMIE), which tracks investments at a project-specific level.

i. **Rising Stalled Projects:** There has been a surge in projects where implementation has stalled. Both in value and volume terms, stalled projects have been rising since early 2009. As of December 2012, six sectors accounted for about 80 per cent of all stalled projects, which were electricity, roads, telecommunication services, steel, real estate, and mining.

ii. **Falling Project Starts:** New investment projects have been drying up across sectors, partly as a consequence of rising stalled projects which reduce the ability of firms to start new ones. New projects of both private sector and government have been falling. Government projects peaked in March 2010 and private-sector projects peaked two quarters later. Ever since, private sector investment levels have been lagging government investments by about six months.

iii. **Causes of slowdown:** Several factors are believed to have caused the stalling of investments and drying up of new investment. A CMIE study *("Sharp Increase in Projects Shelved"*, CMIE, May 2012) shows that in 2011-12, 20 projects accounted for almost 70 per cent of total cost of shelved projects. An analysis of these 20 individual projects suggests difficulties in land acquisition, coal linkages, and mining bans as major causes. Analysis of other stalled projects suggests that policy issues such as in telecom spectrum allocations have also played a role. Several sectors such as consumer non-durables, which are less subject to the type of permissions described above and are more driven by demand conditions and GDP growth, are also seeing a slowdown in new investments. For example, there is a slowdown in new investments in manufacturing food and agro-based products. Lack of growth and slowdown in investment are feeding into each other, with causation flowing both ways. High interest rates have contributed to the depressed investment climate as well. However, given the stability in the repo rate between April and December 2012, the latest quarterly data suggest that interest costs of companies have moderated slightly.

iv. **Way forward:** The government has taken some steps to kick-start investments. The Cabinet Committee on Investments (**CCI**) has been set up to fast-track projects more than Rs. 1,000 crore. The Land Acquisition and Rehabilitation and Resettlement (**LARR**) Bill, which has been cleared by the Cabinet, could bring greater clarity, reduce uncertainty, and thereby aid investments. Investments by cash-rich public-sector units (PSU) have the potential of crowding-in the private sector. Progress on the Delhi-Mumbai Industrial Corridor has the potential of providing a fillip to the investment climate of the country. Policy rate cuts by the RBI and improving business sentiments could also support a revival in investments.

In what follows, the recent trends in various components of investment are discussed to understand the decline in overall investment rate.

T o *summarise*, overall investment would have slowed further were it not for non-productive investment such as in valuables. Particularly worrisome is the sharp slowing of corporate investment, which is the source of future supply (needed to quell inflation) and of future growth potential. Policies to remove investment bottlenecks as well as structural reforms to encourage productive

investment and its financing are essential, as is more accommodative monetary policy, as inflation abates.

Net Exports

Growth in net exports can be an important source of demand. Unfortunately for India, net exports growth has been low because of global weakness. The *World Economic Outlook* (WEO) Update released by the IMF in **January 2013** put the rate of growth of world output at 3.9 per cent in 2011 and 3.2 per cent in 2012, down from 5.1 per cent in 2010. For the advanced economies, the growth rate was much lower at 3 per cent, 1.6 per cent, and 1.3 per cent for 2010, 2011 and 2012 respectively. The growth rate in the faster growing emerging economies also fell over this period.As a result of weak growth in trading partner countries, Indian exports also declined. In the first half of FY 2012-13 (April-September 2012), there was a steep decline in exports while imports did not decline as much in percentage point terms. *Inelastic oil imports* were the primary reason for the relatively smaller decline of imports. But gold imports, which have surged in recent years on the back of higher perceived returns on gold holdings, contributed significantly to imports, even though they declined in value over the previous year. As a result of the widening of the trade deficit and moderation in net invisibles surplus, the CAD worsened to 4.6 per cent of GDP during H1 of 2012-13 as compared to 4.0 per cent of GDP in H1 of 2011-12[*].

With investment, consumption, and net exports all slowing in 2012-13, only an increase in government spending could hold up economic growth. But the government deficit had already shot up as a result of past expansionary policy to pull India out of the post global financial crisis slump. And it increased further as slow growth diminished revenues.

Public Finance

Following the global financial crisis and the slowdown in aggregate demand that followed, **fiscal stimulus** was injected in 2008-09 and 2009-10 and the fiscal deficit of the centre increased to 6.0 per cent and 6.5 per cent of GDP respectively. Fiscal consolidation resumed in 2010-11 with a partial withdrawal of the fiscal stimulus. With growth in GDP recovering sharply in 2010-11, the fiscal deficit of the centre declined to 4.8 per cent of GDP. A large part of this was on account of the growth in nominal GDP in excess of 20 per cent.

This momentum could not be sustained in 2011-12 as growth faltered. The fiscal deficit of the centre widened to 5.7 per cent of GDP in 2011-12 (as per the Provisional Actuals). The dynamic nature of the relationship between macroeconomic outcome and the fiscal outcome was manifest thus: the sharp slowdown in industrial output led to a slowdown in overall GDP growth affecting tax revenues, particularly corporate income tax (the hitherto most buoyant source) the persistence of inflation that necessitated a tight monetary policy stance to rein in demand also dampened investment; subdued financial markets that hampered the planned disinvestment programme, resulting in slippage over Budget Estimates (BE); and continued high levels of global prices of crude oil and fertilisers with inadequate pass through to domestic consumption led to higher-than-budgeted subsidy outgo. Thus, the slippage in fiscal deficit in 2011-12 resulted from slippage of 35 per cent in revenue receipts, 23 per cent in disinvestment receipts and recovery of loans, and 42 per cent in expenditure outgo.

The Gold Rush[1]

1. **Demand for gold has been rising worldwide :** The global financial crisis, turned debt crisis, has seen a steep rise in commodity prices, especially gold. This, now in hindsight, rather unsurprising fact, has mostly been driven by the meteorically increasing demand for safe havens to park the world's savings. Global gold prices, as denominated in US$, have doubled since 2008, and increased three times as denominated in Indian rupees.
2. **India has traditionally been a major absorber of world gold :** The last three years have seen a substantial rise in gold imports (the value of gold imports increased nine times between January 2008 and October 2012), contributing significantly to the current account deficit along with oil.
3. **Gold imports are positively correlated with inflation :** High inflation reduces the return on other financial instruments. This is reflected in the negative correlation between rising imports and falling real rates. Even though real rates have started rising, they are barely in the positive territory.
4. **Reduce Gold Purchases to curb CAD :** Given soaring energy and transportation needs, since there seems to be little we can do to temper oil imports, gold is the component that needs to be contained to bring the CAD back to a comfort zone.
5. **The demand for gold as an investment tool has been increasing over time[2] :** Gold has been a combination of investment tool and status symbol in India. With limited access to financial instruments, especially in the rural areas, gold and silver are popular savings instruments. The recent economic uncertainty has seen people across the board buy gold. Almost all of India's demand for raw gold is met through imports[3]. The composition of gold has seen a steady movement towards non jewellery items. Anecdotally, this can be construed as a rising demand for pure investment, predominantly in the urban and semi-urban areas. In the last quarter, non-jewellery constituted 40 per cent of the total demand. This observation, in line with global trends, is easily explained by the declining real returns on the gamut of financial instruments available to the investor and soaring ones on gold (23.7 per cent annual average return between April 07 and March 2012 versus 7.3 per cent return on Nifty and 8.2 per cent on savings deposits, Sehgal et. al., 2012).
6. **The longer term way to address the rising demand for gold :** The overarching motive underlying the gold rush is high inflation and the lack of financial instruments available to the average citizen, especially in the rural areas. The rising demand for gold is only a "symptom" of more fundamental problems in the economy. Curbing inflation, expanding financial inclusion, offering new products such as inflation indexed bonds, and improving saver access to financial products are all of paramount importance.

These macroeconomic developments broadly continued through the first half of the current fiscal. Concerns were raised in many quarters about the deterioration in the fiscal position for a second year in a row and the credibility of the fiscal policy stance. Recognising that some of the assumptions made at the time of budget formulation needed to be reviewed and corrective policy measures put in place, the government appointed a **committee** headed by *Dr Vijay Kelkar* to chalk out a roadmap for

fiscal consolidation.

Following its recommendations, the government unveiled a revised fiscal consolidation roadmap in October 2012:

- It targeted a fiscal deficit of 4.8 per cent of GDP for 2013-14 and through a correction of 0.6 percentage point each year thereafter, a fiscal deficit of 3.0 per cent of GDP in 2016-17.
- Controlling the expenditure on subsidies will be crucial. Domestic prices of petroleum products, particularly diesel and liquefied petroleum gas (LPG) need to be raised in line with the prices prevailing in international markets. A beginning has already been made with the decision in September 2012 to raise the price of diesel and again in January 2013 to allow oil marketing companies to increase prices in small increments at regular intervals. The number of subsidised gas cylinders has also been capped at nine.
- Efforts will also have to be made to contain subsidies through better targeting, limit other expenditures, and raise revenues over time so as to take the revenue to GDP ratio to 2007-08 levels.
- The disinvestment process has also been speeded up. Taking all these measures into account, the Mid-Year Economic Analysis 2012-13 indicated a likely slippage in the fiscal deficit for the current fiscal by only 0.2 percentage point.

In terms of the implied year-on-year growth envisaged by BE 2012-13 over provisional actuals of 2011-12, there is **slippage** in the first nine months of the current fiscal in corporate income tax by 4.9 percentage points, customs by 18.9 percentage points, and central excise by 16 percentage points.

There is **overperformance** in service tax collection by 5.9 percentage points and personal income tax by 7.6 percentage points. In terms of overall gross tax revenue, there is **slippage** of 6 percentage points in April-December 2012. Going forward, the realisation in the fourth quarter will determine the extent of shortfall for the year over BE.

The outcome in terms of the **fiscal deficit** of the centre broadly indicates that the slippage will be limited to 0.2 percentage point on account of the expenditure measures that could help offset the shortfall in non-debt receipts. The crucial lesson that emerges from the fiscal outcome in 2011-12 and 2012-13 is that in times of heightened uncertainties, there is need for continued risk assessment through close monitoring and for taking appropriate measures for achieving better fiscal marksmanship. Open ended commitments such as uncapped subsidies are particularly problematic for fiscal credibility because they expose fiscal marksmanship to the vagaries of prices.

Who Gets LPG Subsidies?[4]

Subsidies should be well targeted at the poor. The reach of subsidies on LPG is highly unequal amongst the poor and rich in rural and urban areas. While there is a significant inequality in the proportion of subsidies received by the poorest and richest households in rural areas, the distribution is more equitable across urban households. However, in both cases, the proportion of subsidies that go to the poor is low.

The proportion of LPG subsidies received by each quintile across rural and urban households

To calculate the distribution of subsidies across households, we use the 64th Round of NSS data and categorise all rural (and urban) households into quintiles based on their per capita household expenditure. Furthermore, we use the reported household expenditure on LPG to calculate the share of each quintile in the total expenditure on LPG. The share in expenditure on LPG for any quintile therefore reflects the proportion of subsidies received by that quintile. From the above graph, we see a highly unequal distribution of subsidies across rural households. The proportion of subsidies that go to the poorest quintile is only 0.07 per cent as compared to 52.6 per cent for the richest quintile. In urban areas, though the proportion of subsidies that go to the poor is still low (around 8.2 per cent), there is a more equitable distribution across the remaining quintiles (19 per cent, 24 per cent, 25 per cent and 23 per cent respectively).

It is better to achive fiscal consolidation partly through a **higher tax-GDP ratio** than merely through reduction in the expenditure to GDP ratio, in view of large unmet development needs. After reaching a peak of 11.9 per cent in 2007-08, the tax-GDP ratio had declined to 9.6 per cent in 2009-10 and was placed at 9.9 per cent in 2011-12. Therefore, raising the tax-GDP ratio to above the 11 per cent level is critical for sustaining the process of fiscal consolidation in the long run. Of course, it is much better to achieve a higher tax-GDP ratio by broadening the base which is taxed rather than increasing marginal tax rates significantly higher and higher tax rates impinge more and more on incentives to undertake taxable activity, while encouraging tax evasion.

Finally, higher fiscal deficits **usually lead** to rising public debt. India's central government liabilities-GDP ratio has in fact come down since 2002-03 because high nominal GDP growth has offset both the new borrowing as well as the nominal interest payments creditors have demanded. Put differently, India has been able to borrow at low real interest rates even while the government has run fiscal deficits. Such a sequence of events cannot be relied upon, which is yet another reason for bringing down the fiscal deficit.

Another way of looking at the **slippage in public finances** is to see it in the context of domestic savings, which is the safest way of financing investment. Large fiscal deficits may imply lower public savings, lower domestic savings, and given a level of investment, larger CADs. Of course, private savings can increase to make up the shortfall in public savings. Unfortunately, after moving up in 2008-09 and 2009-10, private savings have declined sharply, compounding the decline in public savings.

REDUCTION IN FINANCIAL SAVINGS

- Much of the financial savings of the household sector are in the form of ***bank deposits*** (around 30 per cent in the 2000s), life insurance funds (22 per cent in the 2000s as against 9.6 per cent in the 1980s), and ***pension*** and ***provident funds*** (16.5 per cent in the 2000s as against 23.6 per cent in the 1980s).
- There has been a decline in the proportion of pension and provident funds, particularly since the late 1990s. This trend continued till 2007-8. These were also the years when the real rate of interest was generally declining.
- There has been some upward movement in the share of pension and provident funds during

2008-9 and 2009-10, partly due to the increase in disposable income of government servants who are significant contributors to these funds, on account of higher pay and arrears arising from the implementation of the recommendations of the Sixth Pay Commission.

- Shares and debentures accounted for 8.3 per cent of total financial savings in the1980s; their share increased to nearly 13 per cent in the 1990s before declining to 4.8 per cent in the 2000s. The reasons for such a trend could be the behaviour of share prices, as reflected by the Bombay Stock Exchange (BSE) Sensex.
- The increase in the proportion of shares and debentures in total financial savings in the 1990s could be ascribed to higher returns (21.4 per cent per annum on an average for the decade) along with lower volatility as reflected by a lower coefficient of variation that declined from 42.3 in 1980s to 33.2 in the 1990s.
- The returns on the BSE Sensex halved to 10.7 per cent in the 2000s and volatility increased as can be seen from the higher value of the coefficient of variation at 60.1. Thus a combination of lower returns and higher volatility in the 2000s vis-à-vis the 1990s could have contributed to the reduced share of shares and debentures in total financial savings.
- This, coupled with high inflation, could also be one of the reasons why **gold** has become a ***'safe haven'*** investment in recent times. Acquisition of gold by the households in the country tends to have a negative impact on savings and on household financial investments.

Domestic Savings

The volume and composition of domestic savings in India have undergone significant changes over the years. The savings rate (gross domestic savings as percentage of gross domestic product at market prices) averaged **18.6** per cent in the 1980s and **23** per cent in the 1990s. The savings rate exceeded **30** per cent for the first time in 2004-05 and has remained above that level ever since. It peaked in 2007-08 at **36.8** per cent and reached an eight-year low of **30.8** per cent in 2011-12 (the latest period for which complete figures are available).

Savings come from **three sources**, viz. *households*, the *private corporate sector*, and the *public sector*. On average, households accounted for nearly *three-fourths* of gross domestic savings during the period 1980-81 to 2011-12. The share declined somewhat in recent years, and in the period from 2004-05 to 2011-12, it averaged 70.1 per cent of total savings. Savings of the private corporate sector accounted for 15 per cent of total savings on an average between 1980-81 and 2011-12. However, during the years 2004-05 to 2011-12, their share increased to 23.2 per cent. The public sector accounted for 10 per cent of total savings on average between 1980-81 and 2011-12. It has been progressively declining and during 2004-05 to 2011-12, public savings as a ratio of total savings averaged 6.7 per cent. Figure 1.5 shows the trends in contribution of the household, private corporate, and public sectors to total savings since 1980-81.

Within ***households***, the share of financial savings vis-à-vis physical savings has been declining in recent years. Financial savings take the form of bank deposits, life insurance funds, pension and provident funds, shares and debentures, etc. Financial savings accounted for around 55 per cent of total household savings during the 1990s. Their share declined to 47 per cent in the 2000-10 decade and it was 36 per cent in 2011-12. In fact, household financial savings were lower by nearly ' 90,000

crore in 2011-12 vis-à-vis 2010-11.

One of the reasons for the increasing share of the **private corporate** sector in total savings could be that there has been an increase in the total profit to output ratio from 3.5 per cent for the 1980s to 5.4 per cent in the 1990s and further to 7.7 per cent in the 2000s in the factories sector (estimated from the information available from the Annual Survey of Industries). There has also been a reduction in certain costs, that is emoluments, interest payments, and fuels as a ratio of total value of output. This reduction has contributed to profits and consequently higher savings of the corporate sector. A slowdown in the industrial sector has an impact on private corporate savings, as was the case in 2008-09 and again in 2011-12, and the revival of this form of savings depends on how fast industry recovers.

Public-sector savings include savings by –

i. Public authorities comprising government administration and quasi-government bodies and departmental commercial enterprises, and
ii. Nondepartmental commercial enterprises.

The share of public savings in total savings progressively declined from over 20 per cent in the 1980s to 7.3 per cent in the 1990s and further to 3.3 per cent in the 2000s. Within public savings, the share of non-departmental PSUs on an average remained in the range of 12-13 per cent during each of the three sub-periods. The share of public authorities in total savings declined by nearly 16 percentage points from a positive contribution of 7.4 per cent in the 1980s to a negative contribution of 8.7 per cent in the 2000s. Public authorities have generally been dis-savers since 1987-88, with large dis-savings since 1998-99.

Prices and Monetary Management

Headline WPI inflation remained relatively sticky around 7 to 8 per cent in the current financial year and moderated to a three-year low of 7.18 per cent in December 2012. Average headline WPI inflation in 2012 (April-December) moderated to 7.55 per cent from 9.35 per cent in the corresponding period of the previous year. The momentum based on seasonally adjusted annualised rate (SAAR) has also been showing a declining trend in the last couple of months for major subgroups of the WPI. The decline is mainly due to moderation in non food manufacturing inflation (*'core inflation'* as defined by the RBI). Core inflation remains muted and declined to 4.24 per cent in December 2012 from its peak of 8.35 per cent in November 2011. Apart from monetary measures taken by the RBI, softening of international and domestic prices of metals, chemicals, and textiles products also contributed to the moderation of core inflation.

Elevated **food inflation**, however, remains an area of concern with inflation gradually inching upwards to double digits in December 2012. ***Unlike the previous year, when food inflation was mainly driven by higher protein food prices, this year the pressure has come mainly from cereals.*** Inflation in cereals has increased to 17.05 per cent in the third quarter of 2012-13 from 6.36 per cent in the first quarter mainly on account of an increase in prices of wheat, rice, and maize. Besides an increase in the minimum support price (MSP) for wheat and rice, inadequate open market availability relative to demand, particularly for wheat, has also resulted in a build-up of price pressure and hardening of inflation for cereals. The recent increase in onion prices in December

2012- January 2013 may also put some pressure on primary food articles inflation. However, milk and other protein items witnessed moderation in inflation in the second and third quarters of 2012-13.

Rising food inflation has also widened the gap between inflation measured in terms of CPIs and

WPI to 3.91 percentage points in December 2012 from 1.55 percentage points in May 2012. However, global commodity prices have remained relatively benign with both energy and non-energy prices registering a decline until recently. As per the ***World Bank's Global Economic Prospects***, except for metals, most global commodity prices are expected to decline further in 2013 and 2014, a silver lining in the tepid global recovery. The impact of benign inflationary expectations internationally will have a moderating impact on domestic prices.

In the meantime though, the RBI has to weigh the costs of rapidly slowing growth against persistent **CPI inflation**. To the extent that the primary component of CPI inflation is food prices, elevated because of supply constraints, the textbook prescription is for the RBI to look through higher food prices even while setting rates to ensure that the 'second round effects' as reflected in core inflation are contained. In other words, set monetary policy based on the behaviour of core inflation. One worry with this more accommodative approach is that CPI inflation, which is what the public sees, is becoming entrenched in the public's expectations. A second worry is that high inflation may be causing anxious investors to shun fixed income investments such as deposits and even turn to ***gold as an inflation hedge***, thus contributing to the CAD. Nevertheless, to the extent that monetary policy has limited influence over certain aspects of inflation such as food prices, it may be appropriate for monetary policy to set rates based on what it can influence, while keeping in mind that nominal interest rates affect many aspects of the economy other than growth and inflation.

From the government's perspective, a major contribution to the fight against inflation will be to reduce the fiscal impetus to demand. Also a focus on incentivising food production through measures other than price supports, while facilitating storage and distribution, can help contain food inflation, which is hard for the RBI to control. Policy on price and procurement supports should be calibrated so as to not encourage more production of crops that are already abundantly supplied. Other measures to increase investment more broadly, and therefore supply, can also help over the medium term.

The BoP and External Position

The CAD in the first half of 2012-13 has been 4.6 per cent of GDP. Available indications do not seem to suggest any improvement in the current account balance in the second half. There is a case for discouraging imports of commodities like **gold** and making efforts to **raise exports**. While the government has 'thrown sand in the wheels' by raising the tariff on gold from 4 per cent to 6 per cent in order to discourage imports and tried to unlock passive gold holdings through gold loans, gold purchases are likely to come down primarily when households see *attractive alternative investment avenues*. Lower inflation will be the key. In the meantime, increasing exports at the present juncture is proving to be a more difficult task, given the slow global recovery. Greater competitiveness of exports through greater corporate productivity as well as better logistics infrastructure will help, as will diversification towards fast growing emerging and frontier markets—which is under way. But a return to strong export growth will depend on the revival of growth in industrial countries.

With net exports declining, India's **balance of payments** (BoP) has come ***under pressure***. So far the

CAD has been financed without drawing on reserves. Net capital flows declined to US$ 40.0 billion (4.8 per cent of GDP) in H1 of 2012-13 as against US$ 43.5 billion (4.8 per cent of GDP) in H1 of 2011-12 (Table 1.9). Net foreign direct investment (FDI) to India decreased but net portfolio flows including foreign institutional investments (FII) increased, with early estimates suggesting an even larger inflow of US$ 9.9 billion in the third quarter as compared to US$ 5.8 billion in the second quarter. Non-resident Indian (NRI) deposits remained robust as did net flows of trade credit. Despite the large CAD, therefore, there was net accretion to reserves (on BoP basis) during H1 of 2012-13 at US$ 0.4 billion. This was, however, lower than the US$ 5.7 billion accretion in H1 of the previous year.

In the current fiscal, **foreign exchange reserves** have fluctuated between US$ 286.0 billion and US$ 295.6 billion. At end January 2013, reserves stood at US$ 295.5 billion, indicating a marginal increase from US$ 294.4 billion at end March 2012. The rupee, however, has been more volatile. Between April 2012 and **January 2013**, the monthly average value of the rupee per US dollar fluctuated significantly, touching an all-time low of Rs. 57.22 per US dollar on 27 June 2012, thus depreciating by 10.6 per cent from Rs. 51.16 per US dollar on 30 March 2012. In the subsequent months of July to September 2012, the rupee appreciated, touching Rs. 51.62 per US dollar on 5 October 2012. It began depreciating again thereafter and the monthly average exchange rate has since been in the range of Rs. 53.02 to Rs. 54.78 per US dollar during October 2012 to January 2013.

The **REER** (real effective exchange rate), which takes into account domestic inflation in India, and is an important determinant of the competitiveness of Indian exports, has depreciated by about 11 per cent since mid-2011.

India's **external debt** stock stood at US$ 365.3 billion at end-September 2012, recording an increase of about US$ 20.0 billion (5.8 per cent) over the end-March 2012 level. This increase has been *primarily on account* of higher NRI deposits, short-term debt, and ECBs. These three components together contributed 94.7 per cent of the total increase in the country's external debt.

The *maturity profile* of India's external debt continues to be dominated by long-term loans. At end-September 2012, long-term external debt at US$ 280.8 billion, accounted for 76.9 per cent of total external debt, while the remaining 23.1 per cent was short-term debt. **Government (sovereign) external debt** stood at US$ 81.5 billion, while non-government debt amounted to US$ 283.9 billion at end-September 2012.

India's external debt has remained within manageable limits as indicated by the **external debt-GDP ratio** of 19.7 per cent and debt service ratio of 6.0 per cent in 2011-12. But the trends in size, source, maturity, and hedging of external debt bear careful monitoring. In particular, regulators will have to be careful about the tendency of some Indian corporations or entities without substantial foreign exchange earnings to leave foreign exchange borrowings un-hedged so as to get 'cheap' foreign financing. Low un-hedged foreign interest rates can be deceptively enticing, leaving the borrower exposed to significantly higher repayments if the rupee depreciates unexpectedly.

In this context, ***regulators have to maintain a balance*** between what is of public importance and what is prudential these are –

i. Areas of public importance, such as infrastructure deserve substantial support. However, these areas of activity may also be risky.

ii. Support should be given by de-risking the areas (policy to speed up infrastructure projects

and ease their completion), through financial development (creating new financing institutions, attracting new investors), or fiscal means (interest subventions, tax breaks) but not by relaxing prudential norms (lower capital requirements, allowing un-hedged foreign borrowing) or riskier capital structures (allowing greater debt ratios).

iii. Ultimately, riskier financing for projects of public importance builds up greater risk for the country because if these projects fail to take off, they impinge on both growth and the financial system at the same time, at a time when the government has fewer resources to cope.

Assessment and Policy Measures

The strong post-financial-crisis fiscal and monetary stimulus in India led to spectacular growth in the immediate aftermath of the crisis. But with corporate and infrastructural investment not keeping pace, and food production constrained, the boost to consumption eventually led to higher inflation. And falling savings, partly as a result of government spending and partly as a result of high inflation, have led to a widening CAD. Monetary policy has been tightened, even as global headwinds to growth have increased. India has been caught in a vicious circle of falling growth and stimulus withdrawal that could well exacerbate the decline. Of some concern is India's increased dependence on foreign borrowing even as growth has slowed.

Because of the slowdown and high levels of leverage, some industry and infrastructure sectors are experiencing an increase in non-performing assets (NPAs). Overall gross **NPAs** of the banking sector increased from 2.36 per cent of total credit advanced in March 2011 to 3.57 per cent of total credit advanced in September 2012. The increase is particularly sharp for the industry and infrastructure sectors. Sub-sectors particularly under stress include textiles, chemicals, iron and steel, food processing, construction, and telecommunications. The increase in gross NPAs is also significantly higher for public sector banks, which are typically more exposed to the distressed sectors.

Some of the reasons for the increase in NPAs are technical (a switch to system-based identification by public-sector banks), but stress also stems from slow growth and project delays. A revival of growth will help contain NPAs, but going forward, more attention will have to be paid to whether projects are adequately capitalised up front given the risks, and to whether distress resolution systems work effectively in recapitalising distressed assets and putting them back to work, while excising ineffective promoters from management and imposing losses on those who contracted to take the risk.

The way out, and the hope for starting a virtuous circle, lies in shifting national spending from consumption to investment, removing the bottlenecks to investment, growth, and job creation, in part through structural reforms, combating inflation both through monetary and supply-side measures, reducing the costs for borrowers of raising financing, and increasing the opportunities for savers to get strong real investment returns.

In practical terms for government policy, this translates into containing the fiscal deficit especially by shrinking wasteful and distortionary subsidies. It means working on reducing the impediments to investment such as delays in getting permissions, clarifying difficult and non-transparent processes for land acquisition, and increasing access to good infrastructure such as power and roads. It warrants reworking the regulatory and incentive structure that keeps small businesses tiny and prevents them from creating good productive jobs. It calls for reducing the barriers to entry in various areas of business and allowing FDI, even while ensuring domestic companies are not disadvantaged.

It entails providing the incentives and means for the farmer to increase production, even while improving the management and the logistics of food procurement and distribution. And it necessitates continuing financial sector reform to increase the entry of new institutions, reduce transactions costs for investors, increase access for borrowers and savers to one another, and improve the quality of regulation.

The government has already taken some important steps in this direction, some of which we have already alluded to. In addition, two helpful potential developments are in sight, one on the revenue side and the other on the expenditure side. The **goods and services tax** (GST), if approved, would replace a number of state and central taxes, make India more of a national integrated market, and bring more producers into the tax net. By improving efficiency as well as revenues, it can add substantially to growth as well as helping government finances. On the expenditure side, the direct benefit transfer scheme that will allow the transfer of government benefits directly to targeted recipient bank accounts can help reduce transactions costs, prevent duplication, leakage, and fraud, and improve choices for the poor. By translating a number of subsidies into equivalent cash transfers, it can avoid price distortions and can target subsidies better to the truly deserving. This will help contain expenditure.

The ***government has also taken a number of steps*** to **revive investment and growth** which comprise –

a. Setting up the CCI (Cabinet Committee on Investment) headed by the Prime Minister to fast-track mega projects of over Rs. 1,000 crore;
b. A scheme for restructuring the debts of state power distribution companies, which includes incentives for them to charge reasonable tariffs so that they do not get over-indebted again;
c. Movement towards a land acquisition bill that will clarify and make the process of land acquisition fairer;
d. Permitting FDI in a number of areas including multibrand retail, power exchanges, and civil aviation;
e. Increasing investment in irrigation, storage and cold storage networks;
f. Undertaking programmes to improve the production of protein foods;
g. Steps have also been taken on financial-sector reform;
h. The Banking Laws (Amendment) Act 2012 strengthens the regulatory powers of the RBI and paves the way for grant of new bank licences by the RBI;
i. The Financial Sector Legislative Reforms Commission is examining the laws governing the financial sector with a remit to suggest ways of modernising them; and
j. A number of steps have been taken by the government, together with the financial sector regulators, for easing savings and investment in the country, both for domestic and foreign investors.

More generally, India's ***situation is difficult*** but steps have been taken to bring the macroeconomy back into balance and growth on track. What is important is to recognize that a lot needs to be done and the slowdown is a wake-up call for increasing the pace of actions and reforms.

Prospects, Short Term and Medium Term

The revival of ***growth in the advanced countries*** is expected to be slow and uncertain at least in the near future, despite the measures being taken on monetary and fiscal fronts. In **Europe**, in particular, this is also being accompanied by changes in the institutional framework. With the ongoing private sector deleveraging and government fiscal consolidation, most analysts have projected only a very moderate global recovery in 2013, which could gather steam in 2014. At the same time, if the **United States** can deal with its fiscal overhang, the potential upside to global growth could be substantial, given the health of US corporations, continuing innovation, low energy costs, and the improving finances of households. Emerging markets can also compensate a little for tepid growth in industrial economies, and the changing direction of Indian exports towards emerging markets can help their revival.

Nevertheless, it is **unlikely** that the support to Indian growth from the global economy will be significant. Indeed, there are two sources of downside risk. First, India is exposed to shifts in the risk tolerance of international investors. Second, India's import bill is strongly tied to the price of oil. Of course, one reason for rising oil prices would be improvements in the global economy, which would mean stronger exports. The more worrisome situation would be if the oil prices rise because of geo-political risks, which would mean increasing investor anxiety and slow world growth.

The **bottomline** is that India cannot take the external environment for granted, and has to move quickly to restore domestic balance. The government is committed to fiscal consolidation. This along with demand compression and augmented agricultural production should lead to lower inflation, giving the RBI the requisite flexibility to reduce policy rates. Lower interest rates could provide an additional fillip to investment activity for the industry and services sectors, especially if some of the regulatory, bureaucratic, and financial impediments to investment are eased.

Given such a scenario, where all the three major sectors of the economy perform better in 2013-14 as compared to 2012-13, the overall economy is expected to grow in the range of 6.1 to 6.7 per cent in 2013-14. Of course, these projections assume a normal monsoon, further moderation in inflation as expected (to induce further relaxation of the tight monetary stance), and mild recovery of global growth as anticipated. Forecasting at potential turning points is difficult, hence the relatively wide range this time.

While the current environment is difficult, the future holds promise, provided we can answer the question that is probably foremost in the minds of India's young population: ***'Where will my job come from?'*** India is creating jobs in industry but mainly in *low productivity* construction and not enough formal jobs in manufacturing, which typically are higher productivity. The high productivity service sector is also not creating enough jobs. As the number of people looking for jobs rises, both because of the population 'dividend' and because share of agriculture shrinks, these vulnerabilities will become important. Because good jobs are both the pathway to growth as well as the best form of inclusion, we have to think of ways of enabling their creation.

Agriculture and Food Management

Indian agriculture has performed remarkably well in terms of output growth, despite weather and price shocks in the past few years. Although agriculture, including allied activities, accounted for only **14.1** per cent of the GDP in 2011-12, its role in the country's economy is much bigger with its share in total employment as high as **58.2** per cent according to the 2001 census. The declining share

of the agriculture and allied sector in the country's GDP is consistent with the normal development trajectory of any fast growing economy, but fast agricultural growth remains vital for jobs, incomes, and food security.

Average annual growth of the agriculture and allied sector during the 11th Plan at **3.6** per cent fell short of the target of 4 per cent but was higher than the average annual growth of 2.5 and 2.4 per cent achieved during the Ninth and Tenth Plans respectively. An important reason for the dynamism of the agriculture sector has been a stepup in the *gross capital formation* (GCF) relative to GDP of this sector. Overall GCF in agriculture (including the allied sector), more than doubled in the last 10 years and registered an average annual growth of 8.1 per cent. During the Eleventh Plan period, foodgrains production witnessed an increasing trend, except in 2009-10. During 2011-12, total foodgrains production reached a record of **259.3** million tonnes. Better agricultural performance in the ***Eleventh Plan*** is a result of:

a. farmers' response to better prices;

b. continued technology gains; and

c. appropriate and timely policies coming together, e.g. increased credit at concessional rates. However, the production of 2012-13 kharif crops is likely to be adversely affected by deficiency in the south-west Monsoon and resultant acreage losses. The output for all the major crops is expected to decline.

Owing to good production of foodgrains in recent years and remunerative MSPs, even states that were traditionally not procuring sufficient foodgrains, e.g. Bihar, Madhya Pradesh, Chhattisgarh, and West Bengal showed significant increase. In recent years, the policy impetus provided by the government has also provided much required stability to agricultural exports.

India does not fare well, however, in terms of agricultural yields or productivity. Improvement in yields holds the key for India to remain self-sufficient in foodgrains. Another challenge is how to maximize agricultural income while adopting a more sustainable agricultural strategy. The concerns here are land and water degradation due to soil erosion, soil salinity, waterlogging, excessive application of nutrients, and overexploitation of water resources in some parts of the country. Better management practices for rehabilitation of degraded land and water resources hold the key. Expenditure on agricultural research also needs to be raised in the Twelfth Five Year Plan.

A **notable feature** of the Indian agricultural sector is the domination of small farmers with small landholdings. This poses a challenge for the adoption of farm mechanisation and generating productive incomes from farm operations. Land-related issues and implementation of land reforms require to be attended to on priority basis to revitalise the agriculture sector. Declining per capita availability of foodgrains is another major concern in India. For ensuring nutritional security, it is not only important to increase per capita availability of foodgrains but also to ensure the right amounts of food items in the food basket of the common man. A thrust on horticulture products and protein-rich items is required for ensuring nutritional security.

Another critical issue is supply-chain management in agricultural marketing in India. It is necessary to evolve mechanisms for linking wholesale processing, logistics, and retailing with farm production activities so as to generate enhanced efficiency, better farm prices, etc. Recently the government allowed ***FDI in retail***, which can pave the way for investment in new technology and marketing of agricultural produce in India. ***Areas of importance may be seen as given below*** –

a. Need for stable and consistent policies where markets play an appropriate role,
b. Private investment in infrastructure is stepped up,
c. The public distribution system (PDS) is revamped,
d. Food price and food stock management improves,
e. And a predictable trade policy is adopted for agriculture.
f. The above-given initiatives need to be coupled with skill development and better research and development (R&D) along with improved delivery of credit, seeds, etc.

INDUSTRY AND INFRASTRUCTURE

The capital goods sector remained weak for the second consecutive year. **Negative growth** was not only experienced across the sub-sectors of the capital goods segment but was also more persistent with only two months in the last twelve months recording positive growth. The production of key capital goods such as machinery and equipment, electrical machinery, and transport segments contracted owing to deceleration in investment, a decline in new projects, and import competition. High interest rates and slower growth in household or retail credit resulted in slower growth in consumer durables.

Sluggish industrial performance also affected corporate performance. The rate of growth of sales of the listed manufacturing companies in the private sector declined from an average of 28.8 per cent in the first quarter of 2010-11 to 11.4 per cent in the second quarter of 2012-13. Interest expenditure increased significantly. Together with a deceleration in the rate of growth of sales, the ratio of net profit to sales also declined.

The aggregate resource flow to industry, including credit disbursed by the banks and money raised in domestic and overseas market through other instruments, however, has been showing some signs for optimism. The total flow of financial resources to the commercial sector in the current financial year so far (up to 11 January 2013) has been higher compared to the corresponding period of the previous year.

The **eight core infrastructure industries** registered a growth of 3.3 per cent during April- December 2012 compared to 4.8 per cent during the same period of the previous year. The decline in growth in the current year so far is mainly on account of negative growth witnessed in the production of coal, natural gas, and fertilisers. Among infrastructure services, freight traffic by railways has been comparatively higher during the first eight months of the current year. In the road sector the National Highways Authority of India (NHAI) achieved 17.3 per cent growth in widening and strengthening of highways during April-November 2012.

A large number of major central-sector projects costing Rs. 150 crore and more are delayed with respect to their latest scheduled dates of completion. Delays in land acquisition, municipal permission, supply of materials, award of work, operational issues, etc. continue to bog down project implementation.

Service Sector

The services sector is the dominant sector in most developed economies of the world and in some developing economies such as India. The **CAGR** of the services sector GDP was **10** per cent for the period 2004-05 to 2011-12. It has clearly outgrown both the industry and agriculture sectors. In 2011-12 and 2012-13, in tune with the general moderation in the economy, the growth rate of the services sector also declined. The services sector is providing employment to more people, but employment growth is probably below the desired pace, given how productive service jobs are.

The slowdown in the rate of growth of services in 2011-12, and particularly in 2012-13, from the double-digit growth of the previous six years, contributed significantly to slowdown in the overall growth of the economy. While some slowdown could be attributed to the lower growth in agriculture and industrial activities, given the backward and forward linkages with services, lower demand from the rest of the world could also have played a part.

Financial Intermediation

The existence of well-developed and efficient financial markets is critical for achieving real economic growth. The country now has a vibrant and transparent financial market in terms of market efficiency, transparency, and price discovery process.

As far as the banking sector is concerned, the focus continues to be on reform initiatives which will facilitate the flow of credit to critical sectors of the economy including agriculture, infrastructure, micro, small and medium enterprises, housing, and export. Financial inclusion and improved accessibility of banking infrastructure remain high on the list of priorities of the government.

The performance of Indian banks during 2011-12 was conditioned to a large extent by the fragile recovery of the global financial markets as well as a challenging operational environment on the domestic front, with persistent high inflation and muted growth performance. Net profit growth of banks slowed down. Though Indian banks remained well-capitalised, concerns regarding growing NPAs persisted.

In the overall context of the evolving macroeconomic situation in the country and global financial developments, the government in close collaboration with the **RBI** and **SEBI** (Securities and Exchange Board of India) has recently taken a number of initiatives to meet the growing capital needs of the Indian economy these are –

a. Launching of the **RGESS** (Rajiv Gandhi Equity Savings Scheme) and SME exchange;
b. Expansion of the **QFIs** (Qualified Foreign Investors) Scheme to facilitate their access to the Indian capital market;
c. Progressive enhancement in the quantitative limits for **FIIs'** investments in various debt categories;
d. Allowing refinancing rupee loans through **ECB** (External Commercial Borrowing) route for Indian companies in the power sector;
e. Reduction in the withholding tax on interest payments on ECBs, and
f. Introducing a new ECB scheme for companies in the manufacturing and infrastructure sector.

Investment sentiment started improving in the last few months with foreign investors reposing more confidence in the Indian economy in general and markets in particular. During the current financial year (up to 31 December 2012), the rise in the indices stood at 11.62 per cent for the Sensex and

11.51 per cent for Nifty. The economic and political developments in the Euro-zone area and United States had an impact on markets around the world including India. The temporary resolution of the 'fiscal cliff' in the US had a positive impact on the markets. Further, the reform measures initiated by the government recently have been received well by the markets.

Human Development

Economic growth though important cannot be an end in itself. The Twelfth Five Year Plan, with its focus on *'Faster, More Inclusive and Sustainable Growth'*, puts the growth debate in the right perspective. The government's targeted policies for the poor, with the prospect of fewer leakages, can help better translate outlays into outcomes.

Expenditure on **social services** by the general government (centre and states combined) has increased in recent years reflecting the higher priority given to this sector. Expenditure on social services increased considerably in the Twelfth Plan, with the education sector accounting for the largest share, followed by health. As a proportion of GDP, expenditure on social services increased from 5.9 per cent in 2007-08 to 6.8 per cent in 2010-11 and further to 7.1 per cent in 2012-13(BE).

Nevertheless, India's expenditure on health as a per cent of GDP is lower than in many other emerging and developed countries and the share of the public sector still lower.

Poverty has declined in the country, though precisely how poverty is measured is currently being examined. Based on the methodology suggested by the Tendulkar Committee, the percentage of people living below the poverty line in the country declined from 37.2 per cent in 2004-05 to 29.8 per cent in 2009-10. Even in absolute terms, the number of poor people declined by 52.4 million during this period. Of this, 48.1 million are rural poor and 4.3 million urban poor. Thus poverty has declined on an average by 1.5 percentage points per year between 2004-05 and 2009-10. The annual average rate of decline during the period 2004-05 to 2009-10 is twice the rate of decline during the period 1993-94 to 2004-05.

In the last few years public expenditure on **social programmes** increased dramatically. In the Eleventh Plan period nearly Rs. 7 lakh crore has been spent on the 15 major flagship programmes. A number of legislative steps have also been taken to secure the rights of people, like –

i. the Right to Information Act, the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA);
ii. the Forest Rights Act; and
iii. the Right to Education (RTE).

However, there are also pressing governance issues like programme leakages and funds not reaching the targeted beneficiaries that need to be addressed. Direct benefit transfer (DBT) with the help of the Unique Identification (UID) number can help plug some of these leakages.

Sustainable Development and Climate Change

Though multilateral efforts on sustainable development and climate change have led to several positive outcomes, there are still **areas of concern** where further work is needed to safeguard the interests of developing countries. The key question to be addressed is equity in the evolving

arrangements. It has to be ensured that domestic goals continue to be nationally determined even as we contribute to the global efforts according to the principle of **CBDR** (Common but Differentiated Responsibilities). More importantly, equity, fair burden sharing, and equitable access to global atmospheric resources have to be protected and addressed more adequately.

With the ***Twelfth Plan's focus*** on **'environmental sustainability'**, India is on the right track. However, the challenge for India is to make the key drivers and enablers of growth like infrastructure, the transportation sector, housing, or sustainable agriculture to grow sustainably. This leads us to the most vital issue: of raising additional resources for meeting the need for economic growth with greater environmental sustainability. More often, it is the resource crunch which is the stumbling block for developing countries like India. While it makes efforts to efficiently and expeditiously bring price signals and other policy instruments into play, India could do much more if new and additional finance and technology were made available through the multilateral processes. There is a case for greater cooperation, action, and innovation, provision of finance and technology for developing countries, and institutions and mechanisms for capacity building.

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* As per a Ministry of Finance release dated 29th March 2013, the CAD of India has reached to the level of 6.7 per cent by the 3rd Quarter (October-December) of the fiscal 2012-13 which is the highest ever level in India's history.

1 Prepared by Mr. Rohit Lamba and Dr. Prachi Mishra. We would like to thank Amresh Acharya at the World Gold Council, Suresh Phadnis at PMEAC, Sneha Arora and Arun Narendhranath at ISB for many discussions.

2 There are three active gold mines, which meet less than 1 per cent of domestic demand.

3 World Gold Council.

References: Sehgal, Sanjay Muneesh Kumar, Wasim Ahmad and Priyanshi Gupta, 2012, "The gold rush and policy options: An empirical study", Department of Financial Studies, University of Delhi.

4 Prepared by Abhijit Banerjee and Gaurav Chiplunkar, cited by the *Economic Survey 2012-13*, p. 14

RAILWAY BUDGET 2013-14

- Comments & Reactions
- Summary of the Budget

COMMENTS & REACTIONS

The Railway Budget was “a mixed bag for India Inc” *(The Economic Times)* which lead to various industries cautioning that the hike in freight charges will fuel inflation, while other chambers suggested some proposals which, if implemented could set the growth multiplier in motion.

“The step to increase the freight charges would increase the inflation. I agree with the freight hike on industrial products, but the Railway Minister should withdraw the hike on urea and farm products as this will hit the aam aadmi,” **Assocham** President Rajkumar Dhoot said. The Budget has proposed to raise the freight charges across the board by an average 5.8 per cent. Assocham termed it as a “soft rail budget’ and said that in its efforts to please all sections of the society, the government has missed yet another opportunity for effective corporatisation of Indian Railways to ensure viable commercial operations. “Capacity constraints of Railways remains the primary issue to be addressed more so, in wake of mounting pressure on passenger and freight services, the Budget could have put more focus on this aspect,” Dhoot said.

CII also said that the move would impact consumers. “It will push the prices and it will have an impact on consumers as they have to bear the huge cost. Inflationary pressure is expected to remain high,” Member, CII Railway Equipment Division Rajeev Jyoti said.

However, **FICCI** Secretary General Didar Singh said that this year’s Rail Budget reflects the difficult economic scenario and contains several proposals which, if implemented, would set a growth multiplier in motion.

AEPC Chairman A Sakthivel said increase in the freight of diesel will further put strain on the apparel and garment sector. “Our movement of goods meant for exports to the ports is mostly via railways. Increased cost will reduce our profit margin further and impact our demand. Therefore, I request government to exempt the freight hike on the exportable goods immediately,” he added.

Exporter’s body **FIEO** too said that the increase in freight rates would add on to the cost of inputs at a time when there is a general slow-down in the economy.

SUMMARY OF THE BUDGET

Thrust of the Budget

The Budget announces a ***‘4-Point’*** Thrust areas they are –

1. Safety
2. Consolidation
3. Passenger Amenities
4. Fiscal Discipline

Some Achievements/Initiatives

- IR (Indian Railways) enters the one billion tonne ***Select Club*** joining Chinese, Russian and

US Railways;
- IR also joins ***Select Club*** running freight trains of more than 10000 tonne load;
- *'Fuel Adjustment Component'* concept to be implemented linking tariffs with movement of fuel prices;
- Target of Rs 1000 crore each fixed for **RLDA** (Rail Land Development Authority) and **IRSDC** (IR Station Development Corporation to be raised through PPP in 2013-14;
- New fund – Debt Service Fund – to be set up to meet committed liabilities of debt servicing for WB and JICA loans for DFC and other future liabilities.

Measures for improving Safety & Security

- Making a *Corporate Safety Plan* for a ten year period (2014-2024)
- Elimination of 10,797 level crossings (LCs) during the 12th Plan and no addition of new LCs to the IR system henceforth
- Introduction of *Train Protection Warning System* on Automatic Signalling Systems
- Rigorous trials of the indigenously developed *Train Collision Avoidance System*
- Using 60 kg rails, 260 meter long welded rail panels and improved flash butt welding technology
- Introduction of 160/200 kmph Self Propelled Accident Relief Trains
- Induction of crash worthy LHB coaches with anti-climb feature
- Rehabilitation of identified 17 distressed bridges over next one year
- Provision of comprehensive fire and smoke detection systems
- Provision of portable fire extinguishers in Guard-cum-Brake Vans, AC Coaches and Pantry Cars in all trains
- Use of fire retardant furnishing materials in coaches
- Measures initiated to deal with elephant related accidents
- Four companies of women RPF personnel set up and another 8 to be set up to strengthen the security of rail passengers, especially women passengers
- Recruitment to RPF with 10% vacancies reserved for women

Rail Based Industries

Following New factories/workshops to be set up:

- A new Forged Wheel Factory at Rae Bareli in collaboration with Rashtriya Ispat Nigam Limited
- A Greenfield Mainline Electrical Multiple Units (MEMU) manufacturing facility at Bhilwara (Rajasthan) in collaboration with State Government and BHEL
- A Coach Manufacturing Unit in Sonepat District (Haryana) in collaboration with State Government
- A Midlife Rehabilitation Workshop at Kurnool (Andhra Pradesh) in collaboration with the

State Government

- Bikaner and Pratapgarh workshops to undertake POH of BG wagons
- A workshop for repair and rehabilitation of motorised bogies at Misrod (Madhya Pradesh)
- A new wagon maintenance workshop in Kalahandi (Odisha)
- A modern signaling equipment facility at Chandigarh through ***PPP route***

Green Initiatives

- Setting up of Railway Energy Management Company (REMC) to harness potential of ***solar*** and ***wind*** energy
- Setting up of 75 MW capacity windmill plants and energizing 1000 level crossings with *solar power*
- Deployment of new generation energy efficient electric locomotives and EMUs
- More usage of agro-based and recycled paper and *ban use of plastic* in catering

Passenger/Rail Users' Amenities

- Identification of 104 important stations for immediate attention to all aspects related to cleanliness
- Progressive extension of bio-toilets on trains
- Provision of concrete aprons on platforms with mechanised cleaning facilities
- Extension of On Board Housekeeping Scheme and Clean Train Stations to more stations and trains
- Extension of Unreserved Ticketing System (UTS), Automatic Ticket Vending Machines (ATVMs), Coin-operated Ticket Vending Machines (CO-TVMs) and scheme of Jan-Sadharan Ticket Booking Sevaks (JTBSs)
- Setting up of six more Rail Neer bottling plants at Vijayawada, Nagpur, Lalitpur, Bilaspur, Jaipur and Ahmedabad
- Pilot project on select trains to facilitate passengers to contact on board staff through SMS/phone call/e-mail for coach cleanliness and real time feedback
- 8-10 more mechanised laundries for quality washing of linen
- Provision of announcement facility and electronic display boards in trains
- Providing free ***Wi-Fi*** facilities on several trains
- Upgrading another 60 stations as ***Adarsh Stations*** in addition to 980 already selected
- Associate voluntary organisations for providing first aid services at railway stations
- Introduction of an **'Anubhuti'** coach in select trains to provide excellent ambience and latest facilities and services
- 179 escalators and 400 lifts at A-1 and other major stations to be installed facilitating elderly and differently abled
- Affixing Braille stickers with layout of coaches including toilets, provision of wheel chairs

and battery operated vehicles at more stations and making coaches wheel-chair friendly

- Some JTBS to be reserved for disabled people
- Curbing malpractices in reserved tickets including tatkal scheme
- Third party audit and tie up with food testing laboratories for food quality control; ISO certified state-of-the-art base kitchens to be set up in railway premises
- Centralized Catering Services Monitoring Cell set up with a **toll free number** (1800 111 321)

Rail Tourism

- Launching multi-modal travel package in cooperation with Jammu & Kashmir state government
- Issuing 'Yatra Parchis' to pilgrims travelling by rail to Mata Vaishno Devi Shrine at the time of railway ticket booking
- Introduction of an educational tourist train with concessional fares - 'Azadi Express' – to connect places associated with freedom movement
- Introduction of executive lounge at 7 more stations, namely, Bilaspur, Visakhapatnam, Patna, Nagpur, Agra, Jaipur and Bengaluru

IT Initiatives

- **'Aadhar'** to be used for various passenger and staff related services
- Internet ticketing from 0030 hours to 2330 hours
- e-ticketing through mobile phones
- Project of SMS alerts to passengers providing updates on reservation status
- Covering larger number of trains under Real Time Information System
- Next-Gen e-ticketing system to be rolled out capable of handling 7200 tickets per minute against 2000 now & 1.20 lakh users simultaneously against 40,000 now

Financial Performance 2012-13

- Loading target revised to 1007 MT against 1025 MT in BE
- Gross Traffic Receipts fixed at Rs. 1,25,680 cr in RE, short by Rs. 6,872 cr over Budget Estimates
- Ordinary Working Expenses retained at BE level of Rs. 84,400 cr; pension payments increased by Rs. 1,500 cr to Rs. 20,000 cr
- Dividend liability to government to be fully discharged
- 'Excess' of Rs. 10,409 cr as against the budget amount of Rs. 15,557 cr
- Loan of Rs.3,000 cr taken in 2011-12 fully repaid along with interest
- Operating Ratio of 88.8% as compared to 94.9% in 2011-12

Budget Estimates 2013-14

- Freight loading of 1047 MT, 40 MT more than 2012-13
- Passenger growth to be 5.2%
- Gross Traffic Receipts to be Rs. 1,43,742 cr i.e. an increase of Rs. 18,062 cr over RE, 2012-13
- Ordinary Working Expenses to be Rs. 96,500 cr
- Appropriation to DRF at Rs. 7,500 cr and to Pension Fund at Rs. 22,000 cr
- Dividend payment estimated at Rs. 6,249 cr
- ***Operating Ratio*** to be 87.8%
- Fund Balances to exceed Rs. 12,000 cr

Annual Plan 2013-14

- Highest ever plan outlay of Rs. 63363 cr
  - Gross Budgetary Support - Rs. 26,000 cr
  - Railway Safety Fund - Rs. 2,000 cr
  - Internal Resources - Rs. 14,260 cr
  - EBR - Market Borrowing - Rs. 15,103 cr
  - EBR - PPP - Rs. 6,000 cr
- 500 km new lines, 750 km doubling, 450 km gauge conversion targeted in 2013-14

Fiscal Discipline

- No supplementary Demands for Grants introduced in Monsoon Session or Winter Session of Parliament
- Loan of Rs. 3,000 cr repaid fully
- 347 projects prioritized with assured funding
- Operationally important projects and also last mile projects to receive liberal funding
- A new fund – Debt Service Fund – set up to meet committed liabilities
- Stringent targets for efficiencies in maintenance of rolling stock and fuel consumption
- Target to create fund balance of Rs. 30,000 cr in the terminal year of the 12th Plan

Staff Welfare

- Fund allocation for staff quarters enhanced to Rs 300 cr
- Provision of hostel facilities for single women railway employees at all divisional headquarters
- Extending treatment facility in case of medical emergency to RELHS beneficiaries to all cities in hospitals empanelled with CGHS and Railways
- Condition of barracks to be improved for RPF personnel
- Provision of water closets and air conditioners in the locomotive cabs to avoid stress being

faced by loco pilots

Training and Recruitment

- 1.52 lakh vacancies being filled up this year out of which 47000 vacancies have been earmarked for weaker sections and physically challenged
- Imparting skills to the youth in railway related trades in 25 locations
- Setting up of a multi-disciplinary training institute at Nagpur for training in rail related electronics technologies
- Setting up of a centralized training institute at Secunderabad – **IRIFM** (Indian Railways Institute of Financial Management)
- Five fellowships in national universities to be instituted to motivate students to study and undertake research on IR related issues at M.Phil and Ph.D. levels
- Setting up of a chair at TERI promoting railway related research to reduce ***carbon footprint***

Sports

- Railway Teams won 9 National Championships in 2012
- Railway Sports Promotion Board awarded the 'Rashtriya Khel Protsahan Puraskar – 2012'

Concessions

- Complimentary card passes to recipients of Rajiv Gandhi Khel Ratna & Dhyan Chand Awards to be valid for travel by 1st Class/2nd AC
- Complimentary card passes to Olympic Medalists and Dronacharya Awardees for travel in Rajdhani/Shatabadi Trains
- Travel by Duronto Trains permitted on all card passes issued to sportpersons having facility of travel by Rajdhani/Shatabadi Trains
- Facility of complimentary card passes valid in 1st class/2nd AC extended to parents of posthumous unmarried awardees of Mahavir Chakra, Vir Chakra, Kirti Chakra, Shaurya Chakra, President's Police Medal for Gallantry and Police Medal for Gallantry
- Police Gallantry awardees to be granted one complimentary pass every year for travel along with one companion in 2nd AC in Rajdhani/Shatabadi Trains
- Passes for freedom fighters to be renewed once in three years

Trains

- 67 new Express trains to be introduced
- 26 new passenger services, 8 DEMU services and 5 MEMU services to be introduced
- Run of 57 trains to be extended
- Frequency of 24 trains to be increased

Metropolitan Projects/Sub-urban Services

- Introduction of first AC EMU rake on Mumbai suburban network in 2013-14
- Introduction of 72 additional services in Mumbai and 18 in Kolkata
- Rake length increased from 9 cars to 12 cars for 80 services in Kolkata and 30 services in Chennai

Tariff Proposals

- Proposal for setting up of **RTRA** (Railway Tariff Regulatory Authority) formulated and at inter-ministerial consultation stage
- Fuel Adjustment Component (FAC) linked revision for freight tariff to be implemented from 1st April 2013
- Supplementary charges for super fast trains, reservation fee, clerkage charge, cancellation charge and tatkal charge marginally increased
- Enhanced reservation fee abolished

UNION BUDGET 2013-14

- Comments & Reactions
- Budget Highlights
- Summary of the Budget

COMMENTS & REACTIONS

Terming India's 2013-14 Budget as fundamentally sound, the Washington based ***USIBC*** (United States India Business Council) lauded the government's plan to accelerate public sector divestment, a move that will stimulate greater efficiencies and productivity. "The government of India recognises that a growth rate of 5 per cent will not run its economic engine fast enough to create the jobs necessary to put India's young population to work," the USIBC President Ron Somers said. "This government well remembers the under-employment so rampant at that time, and in this 2013 budget, the Finance Minister has taken some corrective steps necessary to revitalise investor enthusiasm, spur growth, and tame government spending," Somers said, reflecting the views of the US corporate sector on the annual Budget.

USIBC reiterated its demand for increased liberalisation in the insurance, pension, defence, and retail sectors. These actions will attract capital and technology to India. Rather than the government resorting to out-dated "command-control" policies or mandates to require companies to manufacture locally, USIBC continues to press for market-based incentives for India to realise manufacturing goals, the statement said.

USIBC also said it is committed to support India in its USD 1 trillion dollar build-out of infrastructure, which will generate jobs and opportunities for both Indian and American companies. To mobilise the funds necessary for India to meet these mammoth targets, USIBC applauded India's important expansion of the capital markets, including increased debt limits for infra tax-free bonds and allowance of FIIs for the first time to trade in foreign exchange.

The Economist remarked – "It was hailed as India's most important budget for at least a decade. The optimists hoped that it might show the Indian economic miracle was back on track. Pessimists feared it would show a country descending into wild populism ahead of a general election due by mid-2014. Being asleep on the job is what Mr Singh's government is accused of over the last half decade and the economic statistics are certainly poor. GDP figures for the last quarter of calendar year 2012, released on the same day as the budget, show growth has slipped to 4.5%, a rate that would have been unimaginably low a couple of years ago. Inflation remains a problem. Indian firms are reluctant to invest. The current account deficit is worryingly large, meaning India is dependent on volatile capital flows. Although India's stock market soared in the last few months of 2012 and in early January, it has been jittery in the last few weeks. In just over a year, *perhaps less*, a new government, and perhaps a new finance minister will be in place. And for all Mr Chidambaram's efforts, the commitment to economic reform among the political class may be skin deep. As he spoke in the chamber, most spending rises were cheered and met with a thumping of desks, not least by Sonia Gandhi, the dynast who heads the ruling congress party. Mr Chidambaram's pledges on improving the investment climate and attracting manufacturing investment, however, were met with icy silence."

The ***Reserve Bank of India*** reacted optimistically and appreciated the Government's attempts at checking the expanding fiscal deficit, which is supposed to give RBI a little bit space to go for a rate cut and ease the hardened interest rate regime. Showing confidence RBI announced a 25 basis point cut in the Repo Rate (to 7.50 per cent) by the mis-March, 2013. But the Central Banking body was not sure whether there will be any further such cut possible in future due to projected inflationary

pressure.

Industry and ***trade*** had a mixed reactions on the Budget though by and large there prevails an atmosphere of optimism among them. Most of the political parties sitting in the opposition viewed the Budget as an election budget.

BUDGET HIGHLIGHTS

- The Union Budget for 2013-14 aims at higher growth rate leading to inclusive and sustainable development as 'mool mantra'.
- Finance Minister makes ***three promises***: to women, youth and the poor. **Nirbhaya Fund** to empower women and to keep them safe and secure. Proposal to set up India's first Women's Bank as a public sector bank Rs. 1,000 crore for skill development of ten lakh youth to enhance their employability and productivity.
- Direct Benefit Transfer (DBT) Scheme to be rolled out throughout the country during the term of UPA Government.
- **Fiscal Deficit** for 2013-14 is pegged at 4.8 percent of GDP. The **Revenue Deficit** will be 3.3 percent for the same period.
- Plan Expenditure placed at Rs. 5,55,322 crore. It is 33.3 percent of the total expenditure while Non Plan Expenditure is estimated at Rs. 11,09,975 crore. The plan expenditure in 2013-14 will be 29.4 percent more than the RE of the current year i.e. 2012-13.
- Substantial rise in allocation to the social sector. Allocation for Rural Development Ministry raised by 46 percent to Rs. 80,194 crore.
- The target for **farm credit** for 2013-14 has been set at Rs. 7,00,000 crore against Rs. 5,75,000 crore during the current year.
- Rs. 10,000 crore earmarked for **National Food Security** towards the incremental cost. Education gets Rs. 65,867 crore, an increase of 17 percent over RE for 2012-13. ICDS gets Rs. 17,700 crore. This is 11.7 percent more than the current year. Drinking water and sanitation will receive Rs. 15,260 crore. Rs. 1,400 crore is being provided for setting up water purification plants to cover arsenic and fluoride affected rural areas.
- Health and Family Welfare Ministry has been allotted Rs. 37,330 crore. National Health Mission will get Rs. 21,239 crore which represents 24.3 percent over the RE.
- The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) will receive Rs. 14,873 crore as against RE of Rs . 7,383 crore in the current year. Defence has been allocated Rs. 2,03,672 crore.
- Rs. 3,511 crore have been earmarked to Minority Affairs Ministry, 60 percent higher than RE for 2012-13.
- The Government will encourage **IDF** (Infrastructure Debt Fund) and allow some institutions to raise tax free bonds upto Rs. 50,000 crore which is 100 percent more than the current year.
- **IIFC** (India Infrastructure Finance Corporation), in partnership with ADB will help infrastructure companies to access bond market to tap long term funds. Income limit under

Rajiv Gandhi Equity Savings Scheme (RGESS) will be raised from Rs. 10 lakh to Rs. 12 lakh.

- First **home loan** from a bank or housing finance corporation upto Rs. 25 lakh entitled to additional deduction of interest upto Rs. 1 lakh.
- Proposal to launch **Inflation Indexed Bonds** or Inflation Indexed National Security Certificates to protect savings from inflation.
- On oil and gas exploration policy, the Budget proposes to move from the present profit sharing mechanism to **revenue sharing**. Natural gas pricing policy will be reviewed.
- On coal, the Budget proposes adoption of a policy of pooled pricing. Benefits or preferences enjoyed by MSME to continue upto three years after they grow out of this category.
- Refinancing capacity of SIDBI raised to Rs. 10,000 crore.
- **TUFS** (Technology Upgradation Fund Scheme) for textile to continue in 12th Plan with an investment target of Rs. 1,51,000 crore.
- For **Basel III** norms compliance, Rs. 14,000 crore will be provided to public sector banks for capital infusion in 2013-14.
- A grant of Rs. 100 crore each has been made to 4 institutions of excellence including Aligarh Muslim University, Banaras Hindu University, Tata Institute of Social Sciences, Guwahati and Indian National Trust for Art and Cultural Heritage (INTACH).
- New taxes to yield Rs. 18,000 crore.
- A surcharge of 10 percent on persons (other than companies) whose taxable income exceeds Rs.1 crore have been levied.
- Tobacco products, SUVs and Mobile Phones to cost more.
- Relief of Rs. 2000 for the tax payers in the first bracket of 2 to 5 lakhs.
- **VCES** (Voluntary Compliance Encouragement Scheme) launched for recovering service tax dues.
- Rs. 9,000 crore earmarked as the first installment of balance of CST compensations to different States/UTs.

SUMMARY OF THE BUDGET

The Union Budget for 2013-14 aims at *'higher growth leading to inclusive and sustainable development.'* With this as ***mool mantra***, the Finance Minister Shri P Chidambaram has sought to increase allocation to key areas and provide incentives for investments and savings while containing the fiscal deficit to 4.8 per cent of GDP.

Fiscal deficit for the current year contained at 5.2 per cent and for the year 2013-14 at 4.8 per cent. Revenue deficit for the current year at 3.9 per cent and for the year 2013-14 at 3.3 per cent. By 2016-17 fiscal deficit to be brought down to 3 per cent, revenue deficit to 1.5 per cent and **ERD**[1] (Effective Revenue Deficit) to zero per cent.

The Finance Minister expressed the hope that India would achieve high economic growth despite

slowdown in the global economic growth. The Minister said that his government has been able to contain the fiscal deficit at 5.2% in 2012-13 by following the path of fiscal consolidation. But the **CAD**[2] (current account deficit) is a greater worry, the Minister added. He, therefore, proposes to encourage foreign investment that is consistent with India's economic objectives. The Finance Minister said that the other areas of concern addressed by his Government are inflation and government expenditure. *"Our efforts in the past few months have brought down headline WPI inflation to about 7.0 percent and core inflation to about 4.2 percent. It is food inflation that is worrying, and we shall take all possible steps to augment the supply side to meet the growing demand for food items,"* he said. The Minister further said that he had no choice but to rationalise government expenditure in view of huge fiscal deficit in 2012-13. "We also took some policy decisions that had been deferred for too long, corrected some prices, and undertook a review of certain tax policies."

Three Promises: To Women, Youth And The Poor

Shri Chidambaram made promises to the **women**, the **youth** and the **poor** - the ***three faces*** that represent the majority of the people of India. Stating that the government pledges to do everything possible to empower the women and to keep them safe and secure, he said that a number of initiatives were underway and many more would be taken by the Government as well as non-government organisations. The Budget announced the setting up of a fund - **Nirbhaya Fund** – with the Government contributing Rs. 1000 crore.

The Budget also announced a Rs. 1,000 crore scheme for training youth to boost their employability and productivity. The National Skill Development Corporation will be asked to set the curriculum and standards for training different skills. Trained youth who pass a test at the end of training will get a monetary reward of Rs.10000 on an average. This initiative is likely to motivate 10 lakh youth.

For the benefit of the poor, the Minister assured that ***DBT*** (Direct Benefit Transfer) schemes will be rolled out throughout the country during the term of the UPA Government. "We are redoubling out efforts to ensure that the digitised beneficiary lists are available; that a bank account is opened for each beneficiary; and that the bank account is seeded with Aadhaar in due course," he said.

Rural Development, Agriculture And Food Security

The allocation for ***Rural Development*** Ministry has been raised by 46 percent to Rs 80,194 crore in 2013-14. Pradhan Mantri Gram Sadak Yojana (PMGSY)-II has been carved out to benefit States that have substantially fulfilled the objectives of PMGSY. This will benefit states such as Andhra Pradesh, Haryana, Karnataka, Maharashtra, Punjab and Rajasthan. Ministry of Agriculture gets a rise of 22 per cent over the revised estimates (RE) for 2012-13, at Rs 27,049 crore. Rs 500 crore is being allocated to start a programme on crop diversification. It will encourage farmers in the original green revolution states to choose alternative crops. A pilot programme on Nutri-Farms will be started for introducing new crop varieties that are rich in micro nutrients, such as iron-rich bajra. A sum of up to Rs 200 crore is to be provided to start the pilots.

The Budget seeks to support Farmer Producer Organisations (FPO), including Farmer Producer Companies (FPC) which have emerged as aggregators of farm produce and link farmers directly to

markets. The target of agricultural credit for 2012-13 (Rs. 5,75,000 crore) is likely to be exceeded, and a target of Rs 7,00,000 crore farm credit has been fixed for the next year. The interest subvention scheme for short-term crop loans is proposed to be continued for loans by public sector banks, RRBs and cooperative banks, and expanded to private scheduled commercial banks. Under the scheme, a farmer who repays the loan on time is able to get credit at 4 percent per year. Rs.307 crore have been provided for setting up of the National Livestock Mission. This will attract investment and enhance livestock productivity. A sub-mission of this Mission seeks to increase the availability of feed and fodder.

Expressing the hope that the National Food Security Bill will be passed by Parliament as early as possible, the Finance Minister has set apart Rs. 10,000 crore towards the incremental cost that is likely under the Act.

Other Major Allocations

Education has been allocated Rs. 65,867 crore, an increase of 17 per cent over the RE for 2012-13.ICDS gets Rs. 17,700 crore representing an increase of 11.7 per cent. A multi-sectoral programme to tackle maternal and child malnutrition that was announced last year will be implemented in 100 districts during 2013-14. It will be further scaled up to cover 200 districts the year after.

Health and Family Welfare has been allocated Rs. 37,330 crore. Of this, the new ***NHM*** (National Health Mission) that combines the *rural mission* and the proposed *urban mission* will get Rs. 21,239 crore - an increase of 24.3 percent over the RE.

Backward Regions Grant Fund (BRGF) has been allocated Rs. 11,500 crore and will include a State component for Bihar, the Bundelkhand region, West Bengal, the KBK districts of Odisha and the 82 districts under the Integrated Action Plan.

Science and Technology related Departments have been allocated funds with substantial enhancements.

National Institute of Sports Coaching is proposed to be set up at Patiala at a cost of Rs. 250 crore over a period of three years.

Drinking water and sanitation will receive Rs. 15,260 crore. Rs. 1,400 crore is being provided for setting up water purification plants to cover arsenic and fluoride effected rural habitations. The *Jawaharlal Nehru National Urban Renewal Mission* (JNNURM) will receive Rs. 14,873 crore as against RE of Rs. 7,383 crore in the current year. Out of this, a significant portion will be used to support the purchase of upto 10,000 buses, especially by hill States.

Defence gets an allocation of Rs. 2,03,672 crore and the assurance that constraints will not come in the way of providing any additional requirement for the security of the nation.

Women, Children, Minorities - stating that adequate funds must be provided for programmes that benefit women, children and minorities, as also the scheduled castes and scheduled tribes, the Finance Minister proposed to allocate Rs 41,561 crore to the scheduled caste sub-plan and Rs 24,598 crore to the tribal sub-plan. The programmes relating to women get Rs. 97,134 crore and child budget, Rs. 77,236 crore. The Ministry of Women and Child Development has been asked to design a scheme that will address women's concerns, and an additional sum of Rs. 2,000 crore has been provided to the Ministry to begin work in this regard. Ministry of Minority affairs has been allocated

Rs. 3,511 crore and the Department of Disability Affairs, Rs. 110 crore.

Investment And Infrastructure

The Finance Minister stated that the key to restart the growth engine was to attract more investment, and that the government will improve communication of its policies to remove any apprehension or distrust in the minds of investors. A number of steps to mobilise investment have been announced in the Budget keeping in view that as per 12th Plan the private sector will share 47 percent of Rs 55,00,000 crore investment in infrastructure. Infrastructure Debt Funds (**IDF**) will be encouraged. India Infrastructure Finance Corporation (**IIFCL**) will offer credit enhancement to infrastructure companies that wish to access the bond market to tap long term funds. Some institutions will be allowed to issue tax - free bonds upto a total sum of Rs 50,000 crore (as against Rs 25,000 crore in 2012-13). Assistance of the World Bank and Asian Development Bank will be sought to build roads in the North Eastern States and connect them to Myanmar. The corpus of Rural Infrastructure Development Funds (**RIDF**) is proposed to be raised to Rs. 20,000 crore. A sum of Rs 5,000 crore will be made available to **NABARD** to finance construction of warehouses, godowns, silos and cold storage units designed to store agricultural produce.

The Minister informed that the newly set-up Cabinet Committee on Investment has held two meetings and taken decisions in respect of a number of oil and gas, power and coal projects. CCI will take up some more projects shortly, he said. The Minister also informed that a regulatory authority is being constituted for the road sector. Bottle – necks stalling road projects have been addressed and 3,000 km of road projects in Gujarat, Madhya Pradesh, Maharashtra, Rajasthan and Uttar Pradesh will be awarded in the first six months of 2013-14.

The Budget introduces an investment allowance for new high value investment. A company investing Rs. 100 crore or more in plant and machinery during the period 01.04.2013 to 31.03.2015 will be entitled to deduct an **investment allowance** of 15 percent of the investment (in addition to depreciation).

Industrial Sector

Plans for seven new cities have been finalized for **industrial corridors** and work on two new smart industrial cities at Dholera (Gujarat) and Shendra Bidkin (Maharashtra) will start during 2013-14. A comprehensive plan is being prepared for the Chennai Bengaluru industrial corridor. Preparatory work has started for the next corridor - Bengaluru Mumbai industrial corridor.

Two **new ports** will be established in Sagar (West Bengal) and in Andhra Pradesh. In addition, a new outer **harbour** will be developed in the VOC port at Thoothukkudi (Tamil Nadu) through PPP at an estimated cost of Rs 7,500 crore.

A **power transmission** system will be constructed from Srinagar to Leh and for this Rs. 226 crore have been provided in 2013-14. The oil and gas exploration policy will be reviewed to move from profit sharing to revenue sharing contracts. A policy to encourage exploration and production of shale gas will be announced. The natural gas pricing policy will be reviewed and uncertainties regarding pricing will be removed.

To provide greater support to Micro, Small and Medium Enterprises (MSMEs), the refinancing

capability of **SIDBI** is proposed to be enhanced from Rs. 5,000 crore to Rs. 10,000 crore per year. SIDBI will also be provided a corpus of Rs 500 crore to set up a Credit Guarantee Fund for factoring. Apparel Parks are proposed to be set up within the Integrated Textile Parks, to house apparel manufacturing units. A new scheme, **IPDS** (Integrated Processing Developing Scheme), is being started to address to environmental concerns of the textile industry. Working capital and term loans to the **handloom** sector will be available at a concessional interest of 6 per cent. This will benefit 1.5 lakh weavers and 1,800 primary co-operative societies.

Savings

The Budget proposes three measures to promote household savings. One, the income limit for **RGESS** (Rajiv Gandhi Equity Saving Scheme) for first time investors is being raised from Rs. 10 lakh to Rs. 12 lakh. Two, persons taking loan for first home up to Rs 25 lakh will be entitled to an additional deduction of interest of up to Rs 1 lakh. Three, instruments such as Inflation Indexed Bonds will be introduced to protect savings from inflation.

Financial Sector

The Budget has proposed to constitute a Standing Council of Experts in the Ministry of Finance to analyse the *international competitiveness* of the *Indian financial sector*. The Finance Minister announced that Rs. 14,000 crore worth of capital infusion will be made into public sector banks. It will be ensured that these banks meet the **Basel III** regulations.

India's **first women's bank** is proposed to be set up with Rs. 1,000 crore as initial capital.

The government has finalised a number of proposals relating to the **insurance** sector in consultation with IRDA. These include empowering insurance companies to open branches in Tier II cities and below without prior approval of IRDA, having an office of LIC and a public general-insurance company in all towns with the population of 10,000, and permitting banks to act as insurance broker. The Rashtriya Swasthiya Bima Yojana, which cover 34 million families below the poverty line, will now be extended to other categories such as rickshaw, auto-rickshaw and taxidrivers, sanitation workers, rag pickers and mine workers. The Budget proposes to evolve a ***comprehensive social security package*** by converging various schemes for life-cum-disability cover, health cover, maternity assistance and pension benefits.

A number of proposals relating to capital market have been finalised in consultation with SEBI. These include simplification of procedure and uniform norms for foreign portfolio investors, clarity relating to FDI investment, allowing FIIs to participate in new areas, etc.

Budget Estimates

The total expenditure in the Union Budget 2013-14 is pegged at Rs. 16,65,297 crore. Out of it Rs.5,55,322 crore (33%) is Plan expenditure. The non-Plan expenditure is estimated at Rs 11,09,975 crore.

The Plan expenditure in 2013-14 will be 29.4 per cent more than the revised estimates of the current year. All flagship programmes have been fully and adequately funded. Juxtaposing economic welfare

with the economic policy, the Minister said that the link between policy and welfare can be expressed in a few words: opportunities, education, skills, jobs and incomes. The Budget has before it one overarching goal to create opportunities for the youth to acquire education and skills that will get them decent jobs or self-employment that will bring them adequate incomes that will enable them to live with their families in a safe and secure environment. The Budget sets a target of skilling 90 lakh people in 2013-14, for which funds will be released by the National Rural Livelihood Mission and National Urban Livelihood Mission.

Taxes

The Budget reiterates that clarity in tax laws, a stable tax regime, a nonadversarial tax administration, a fair mechanism for dispute resolution and independent judiciary for greater assurance is **underlying theme** of tax proposals. It is proposed to set up the **TARC** (Tax Administration Reforms Commission).

As regards ***Direct Taxes***, a relief of Rs. 2000 for the Tax Payers in the first bracket of Rs. 2 lakhs to Rs. 5 lakhs have been proposed. A surcharge of 10 percent on persons (other than companies) whose taxable income exceeds Rs.1 crore have been levied. Surcharge has been increased from 5 to 10 percent on domestic companies whose taxable income exceed Rs. 10 crore. In case of foreign companies, surcharge will increase from 2 to 5 percent, if the taxable income exceeds Rs. 10 crore. Additional surcharges to be in force for only one year. Mr. Chidambaram said, education cess to continue at 3 percent.

The Budget has announced the grant of **investment allowance** at the rate of 15 percent to manufacturing companies that invest more than Rs. 100 crore in plant and machinery during the period 01.04.2013 to 31.03.2015. Concessional rate of tax of 15 per cent on dividend received by the Indian companies from its foreign subsidiary proposed to continue for one more year. It is proposed that TDS at the rate of one percent on the value of the transfer of immovable property where the consideration exceeds Rs. 50 lakhs to be levied. Agricultural land to be exempted from TDS.

Modified provisions of **GAAR** will come into effect from 1st April, 2016. It is also proposed to increase the rate of tax on payments by way of royalty and fees for technical services to non-residents from 10 percent to 25 percent.

The Budget proposes to introduce **CTT** (Commodities Transaction Tax) in a limited way. However, agricultural commodities will be exempted. A number of administrative measures such as extension of refund banker system to refund more than Rs. 50,000, technology based processing, extension of e-payment through more banks and expansion of in the scope of annual information returns by Income-tax Department.

With regards to **Indirect Taxes**, the Finance Minister proposed no change in the normal rates of 12 percent for *excise duty* and *service tax*. Similarly, no change has been made in the peak rate of custom duty of 10 percent for non-agricultural products. Custom duty on free **gold** limit increased to Rs. 50,000 in case of male passenger and Rs. 1,00,000 in case of a female passenger subject to conditions. Duty on imported luxury goods such as high end motor vehicles, motor cycles, yachts and similar vessels increased. Custom duty on Set Top Boxes increased from 5 to 10 percent while on raw silk increased from 5 to 15 percent to boost domestic production. Custom duty on specified machinery for manufacture of leather and leather goods including footwear reduced from 7.5 to 5

percent. The Budget also proposes that period of concession available for specified part of electric and hybrid vehicles extended upto 31 March 2015.

Excise duty on **SUVs** increased from 27 to 30 percent. However, this will not apply to SUVs registered as taxies. Cigarettes will cost more as specific excise duty increased by about 18 percent. Similar increases are proposed on cigars, cheroots and cigarillos. Duty on mobile phones priced above Rs. 2000 has been raised to 6 percent from the current one percent.

The Budget proposes **VCES** (Voluntary Compliance Encouragement Scheme) where a defaulter may avail of the scheme on condition that he files a truthful declaration of Service Tax dues since 01.10.2007. It is a one-time scheme in which interest, penalty and other consequences will be waived.

The Budget proposes to mobilise Rs. 18,000 crore in which new proposals in indirect taxes will yield Rs. 4,700 crore and direct taxes of Rs. 13,300 crore. In a major step to rationalise taxation on goods and services, the Budget has earmarked Rs. 9,000 crore towards the first installment of the balance of CST compensation. The Minister said that overwhelming majority States have agreed that there is a need for Constitutional amendment to pass **GST** law. It will be drafted by the State Finance Ministers and the GST Council, the Minister added.

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1. Effective Rvenue Deficit (ERD) is not a terminology used by other economies of the world (as they use 'accrual basis' accounting in their expenditures statements). In India by ERD the GoI means the Revenue Deficit (RD) after deducting its expenditures on account of the GoCA (Grants for Capital Assets) from its existing RD. The GoCA includes the GoI grants forwarded to the states for the implementation of the Centrally sponsored programmes such as Pradhan Mantri Gram Sadak Yojana, Accelerated Irrigation Benefit Programme, Jawaharlal Nehru National Urban Renewal Mission, etc. – these expenses though they are shown by the government in its Revenue Expenditures they are involved with asset creation and can not be considered completely 'unproductive' like other items put in the Revenue Expenditures – the reason why the GoI does not consider them as part of its RD and a new concept ERD has been eveloved.
2. As per a Ministry of Finance release dated 29th March 2013, the CAD of India has reached to the level of 6.7 per cent by the 3rd Quarter (October-December) of the fiscal 2012-13 which is the highestever level in India's history.

CENSUS-2011

- Introduction
- Census of India 2011
- New Features
- Caste-Based Census
- Census Data
- Highlights of The Census-2011
- Diagrammatic Highlights of The Census

INTRODUCTION

The Indian Census is a credible source of statistical information on different characteristics of the citizens since 1872. This was conducted at different points of time in different parts of the country. It was in 1881 that a Census was taken for the entire country simultaneously. Since then, Census has been conducted every ten years, without a break. The Census provides a snapshot of the country's population and housing at a given point of time. The Office of the Registrar General and Census Commissioner, India, under the Union Ministry of Home Affairs is the ***nodal authority*** for conducting decennial Census in the country. Census 2011 is the 15th National Census of the country since 1872 and the 7th after Independence.

The Indian Censuses have throughout evoked interest worldwide but have become of greater interest since 2001 when the country population crossed one billion marks. Taking count of the large size of the population, especially when it is continuing to grow made 2011 Census another challenge. Like in the past censuses, the census organisation undertook publicity by various means to create awareness amongst the public for participating in the Census.

Census provides detailed and authentic information on demography, economic activity, literacy and education, housing & household amenities, urbanisation, fertility and mortality, Scheduled Castes and Scheduled Tribes, language, religion, migration, disability and many other socio-cultural and demographic data. This information helps the Central and State Governments in planning and formulation of various policies. Besides, the delimitation or reservation of constituencies—Parliamentary/Assembly/Panchayats and other local bodies—are also based on demographic data.

According to ***Article 246*** of the Constitution of India, population Census is a Union Subject. But, the State Governments provide administrative support in conducting the Census process.

The Office of the Registrar General and Census Commissioner, headed by the Registrar General and Census Commissioner, plans and implements Census. There are field offices, headed by Directors of Census Operations, in all the States and Union Territories (except Dadra and Nagar Haveli and Union Territory of Daman and Diu, which are attached to the office at Gujarat). Directors of Census Operations are responsible for the conduct of Census in their respective jurisdiction.

CENSUS OF INDIA 2011

The ***provisional figures*** of Census 2011 were released by the Ministry of Home Affairs on 31st March, 2011. The **final data** were released in March 2011–still some data are to come. Census 2011 was conducted in two phases.

The first phase, called the ***House Listing*** or Housing Census was conducted between April and September last year across the country, depending on the convenience of different States/UTs. The second phase, ***Population Enumeration***, began simultaneously all over the country from February 9, 2011 and continued up to February 28, 2011.

NEW FEATURES

This Census has incorporated some ***new categories*** for the first time for the purpose of acquiring comprehensive and better data. The new categories are as follows:

- **Gender**: New category "Other" introduced in addition to Male and Female.
- **Date of Birth**: a new question introduced along with **Age**.
- **Current Marital Status**: Separate codes Assigned for Separated and Divorced.
- New filter **Question on SC/ST** Introduced— "Is this person SC/ST?"
- **Disability**: Household Schedule of Census 2011 attempts to collect information on eight types of disabilities as against five included in the Household Schedule of Census of India 2001. The information is being collected on disabilities namely, disability 'In Seeing', 'In Hearing', 'In Speech', 'In Movement', 'Mental retardation', 'Mental Illness', 'Any Other' and 'Multiple Disability'.
- **Literacy Status** for "Other" sex added in addition to existing Male and Female.
- New Codes under Status of **Attendance in Educational Institutions** introduced for Not Attending viz., (i) Attended before and (ii) Never attended.
- **Work**: Marginal workers have been classified into two categories viz., (i) worked for 3 months or more but less than 6 months (ii) worked for less than 3 months. The definition of 'Main worker' remains the same.
- A separate code-5 has been included under **Non-economic** activity for renters.
- **Migration**: Provision to specify the present name of the Village/Town of the Birth Place as well as the Place of Last Residence introduced.
- **Name** of the Institutional Household is also being recorded.

Census 2011, for the ***first time***, has taken a new initiative to *sensitise school students* about census operations. The Census Organization implemented ***"Census in School'*** programme across the country. This was specifically designed for the active participation of children in ensuring authenticity of census data of their families.The programme covered about 60 to 80 schools in each of the 640 districts in the country.

A ***mascot*** of an enumerator was also created for Census 2011 to make the process more people-friendly with the objective of helping people to relate with the Census process and elucidate the key role of enumerators in the process.

CASTE-BASED CENSUS

Following demands from several ruling coalition leaders and many opposition parties this was decided to include caste-based informations to be collected during the Census. Information on caste was last collected during British Raj in 1931. During the early census, people often exaggerated their caste status to garner social status and it is expected that people downgrade it now in the expectation of gaining government benefits.

There is only *one instance* of a caste-count in post-Independent India. It was conducted in Kerala in 1968 by the Communist government under E. M. S. Namboodiripad to assess the social and economic backwardness of various lower castes. The census was termed Socio-Economic Survey of 1968 and the results were published in the Gazetteer of Kerala, 1971.

CENSUS DATA

According to provisional results, India's population grew to 1.21 billion. The absolute number of children in the 0–6 age group recorded decline from 163 million in the 2001 census to 158 million in 2011.

Number of Administrative Units in Census 2011

- State/Union Territories: 35
- Districts: 640
- Sub-districts: 5,924
- Towns: 7,938
- Villages: 6.41 Lakh

The cost of Census 2011 has been estimated at '22,000 million, which works out to a per person cost of '18.19. A total of 2.7 million functionaries worked in the process with the census schedules in 16 languages- a total of 340 million schedules were printed.

National Population Register (NPR)

A milestone of Census 2011 is the creation of National Population Register (NPR). The National Population Register (NPR) will build up a comprehensive identity database of usual residents of the country. It would have the ***biometric data*** and ***UID Number*** of every person (15 years and above). National Identity Cards will be given in a phased manner to all usual residents by the Office of the Registrar General and Census Commissioner, India. The NPR is being introduced for the ***first time*** in the country.

National Population Policy 2000

The National Population Policy, 2000 (NPP 2000) affirms the commitment of the Government towards voluntary and informed choice and consent of citizens while availing of reproductive health care services, and continuation of the target free approach in administering family planning services. The NPP 2000 provides a policy framework for advancing goals and prioritizing strategies during the next decade, to meet the reproductive and child health needs of the people of India, and to achieve net replacement levels (TFR) by 2010. It is based upon the need to simultaneously address issues of child survival, maternal health, and contraception, while increasing outreach and coverage of a comprehensive package of reproductive and child health services by government, industry and the voluntary non-government sector, working in partnership.

The ***immediate objective*** of the NPP 2000 is to address the unmet needs for contraception, health care infrastructure, and health personnel, and to provide integrated service delivery forbasic reproductive and child health care. The ***medium-term objective*** is to bring the TFR (Total Fertility Rate) to replacement level (i.e. 2.1) by 2010, through vigorous implementation of inter-sectoral operational strategies. The ***long-term objective*** is to achieve a stable population by 2045, at a level consistent with the requirements of sustainable economic growth, social development, and environmental protection.

In pursuance of these objectives, the following **National Socio-Demographic Goals** were set by the Government of India to be achieved in each case by 2010 (***one year before the next Census***):

- Address the unmet needs for basic reproduc-tive and child health services, supplies and infrastructure.
- Make school education up to age 14 free and compulsory, and reduce drop outs at primary and secondary school levels to below 20 percent for both boys and girls.
- Reduce infant mortality rate to below 30 per 1000 live births.
- Reduce maternal mortality ratio to below 100 per 100,000 live births.
- Achieve universal immunization of children against all vaccine preventable diseases.
- Promote delayed marriage for girls, not earlier than age 18 and preferably after 20 years of age.
- Achieve 80 percent institutional deliveries and 100 percent deliveries by trained persons.
- Achieve universal access to information/counseling, and services for fertility regulation and contraception with a wide basket of choices.
- Achieve 100 per cent registration of births, deaths, marriage and pregnancy.
- Contain the spread of Acquired Immunodeficiency Syndrome (AIDS), and promote greater integration between the management of reproductive tract infections (RTI) and sexually transmitted infections (STI) and the National AIDS Control Organisation.
- Prevent and control communicable diseases.
- Integrate Indian Systems of Medicine (ISM) in the provision of reproductive and child health services, and in reaching out to households.
- Promote vigorously the small family norm to achieve replacement levels of TFR.
- Bring about convergence in implementation of related social sector programs so that family welfare becomes a people centred programme.

Population growths in India continue to be high due to so may *inter-related* and *independent* factors. The factors may be seen as follows:

- The large size of the population in the reproductive age-group (estimated contribution 58 percent). An addition of 417.2 million between 1991 and **2016** is anticipated despite substantial reductions in family size in several states, including those which have already achieved replacement levels of TFR. This momentum of increase in population will continue for some more years because high TFRs in the past have resulted in a large proportion of the population being currently in their reproductive years. It is imperative that the the reproductive age group adopts without further delay or exception the *"small family norm"*,

for the reason that about 45 percent of population increase is contributed by births above two children per family.

- *Higher fertility* due to unmet need for contraception (estimated contribution 20 percent). India has 168 million eligible couples, of which just 44 percent are currently effectively protected. Urgent steps are currently required to make contraception more widely available, accessible, and affordable. Around 74 percent of the population lives in rural areas, in about 5.5 lakh villages, many with poor communications and transport. Reproductive health and basic health infrastructure and services often do not reach the villages, and, accordingly, vast numbers of people cannot avail of these services.
- High wanted fertility due to the *high infant mortality rate* (IMR) (estimated contribution about 20 percent). Repeated child births are seen as an insurance against multiple infant (and child) deaths and accordingly, high infant mortality stymies all efforts at reducing TFR.
- Over 50 percent of girls marry below the age of 18, the minimum legal age of marriage, resulting in a typical reproductive pattern of *"too early, too frequent, too many"*. Around 33 percent births occur at intervals of less than 24 months, which also results in high IMR.

HIGHLIGHTS OF THE CENSUS-2011

The major **highlights** of the Census 2011 are as under:

- The **population** of the country is 1210.19 million of which 623.72 million (51.54%) are males and 586.46 million (48.46%) are females.
- The population of India has increased by more than ***181 million*** during the decade 2001–2011.
- Decadal growth rate of the population (2001–2011) has been 17.64 per cent (**i.e. 1.76 % per year**); males 17.19 and females 18.12.
- 2001–2011 is the ***first decade*** (with the exception of 1911–1921) which has actually added lesser population compared to the previous decade.
- Uttar Pradesh (199.5 million) is the **most populous** State in the country followed by Maharashtra with 112 million.
- The percentage decadal growth rates of the six most populous States have ***declined*** during 2001–2011 compared to 1991–2001:
  - Uttar Pradesh (25.85% to 20.09%)
  - Maharashtra (22.73% to 15.99%)
  - Bihar (28.62% to 25.07%)
  - West Bengal (17.77 % to 13.93%)
  - Andhra Pradesh (14.59% to 11.10%)
  - Madhya Pradesh (24.26% to 20.30%)
- During 2001–2011, as many as 25 States/UTs with a share of about 85% of the country's population registered an annual growth rate of less than 2% as compared to, 15 States/UTs

with a share of about 42% during the period 1991–2001.

- 15 States/UTs have grown by less than 1.5 per cent per annum during 2001–2011, while the number of such States/UTs was only 4 during the previous decade.
- The total number of children in the age-group 0–6 is 158.8 million (-5 million since 2001).
- Twenty States and Union Territories now have over one million children in the age group 0–6 years. On the other extreme, there are five States and Union Territories in the country that are yet to reach the one hundred thousand mark.
- Uttar Pradesh (29.7 million), Bihar (18.6 million), Maharashtra (12.8 million), Madhya Pradesh (10.5 million) and Rajasthan (10.5 million) constitute 52% children in the age group of 0–6 years.
- Population (0–6 years) 2001–2011 registered minus (–) 3.08 percent growth with minus (–) 2.42 for males and –3.80 for females
- The proportion of ***Child Population*** in the age group of 0–6 years to total population is ***13.1*** percent while the corresponding figure in 2001 was 15.9 percent. The decline has been to the extent of 2.8 points.
- Overall **sex ratio** at the national level has increased by 7 points to reach **940** at Census 2011 as against 933 in Census 2001. This is the ***highest*** sex ratio recorded since Census 1971 and a shade lower than 1961. Increase in sex ratio is observed in 29 States/UTs.
- Three major States (J&K, Bihar & Gujarat) have shown decline in sex ratio as compared to Census 2001.
- Kerala with 1084 has the **highest sex ratio** followed by Puducherry with 1038; Daman & Diu has the **lowest sex ratio** of 618.
- **Child sex ratio** (0–6 years) is 914. Increasing trend in the child sex ratio (0–6) seen in Punjab, Haryana, Himachal Pradesh, Gujarat, Tamil Nadu, Mizoram and A&N Islands. In all remaining 27 States/UTs, the child sex ratio show decline over Census 2001.
- Mizoram has the ***highest child sex ratio*** (0–6 years) of 971 followed by Meghalaya with 970. Haryana is at the bottom with ratio of 830 followed by Punjab with 846.
- **Literacy** rate has gone up from 64.83 per cent in 2001 to **74.04** per cent (*aged 7 and above*) in 2011 showing an increase of 9.21 percentage points. Percentage growth in literacy during 2001–2011 is 38.82; males: 31.98% and females: 49.10%.

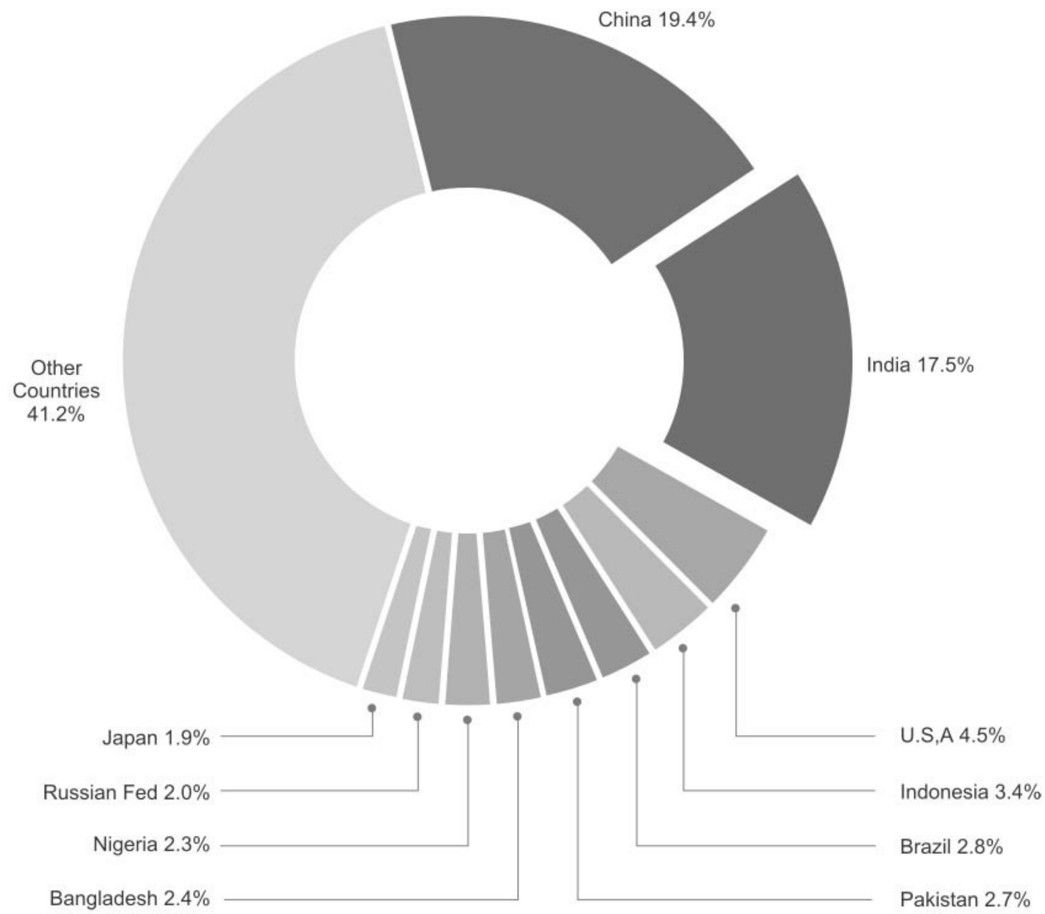
The Way Ahead

The Census also talks about the rising population and the solutions regarding checking it. The discussion takes recourse to the famous Theory of Demographic Transition. A country which has added a size of population equa to the 5th most populous country in the world (Brazil), the pressure on the resources may be just imagined in India! The speed with which India is adding population poses a big challenge in front of almost every kind of *planning* in the country. The immediacy to check the rising population has been highlighted by the Census. Without overall development in the living standards of the population, checking population will not be possible. This is why since the launching of the NPP–2000, the governments are trying to ***tag-in*** all the programmes focused at

poverty alleviation, employment generation, healthcare, etc to realise the single goal—***let peoples' living standard improve***. The changed policy stance seems having an impact on the population growth rate—the country going for decreased rate of population growth rate in the decade gone by.

DIAGRAMMATIC HIGHLIGHTS OF THE CENSUS

INDIA in the WORLD: India's population (1210.2 million) is almost equal to the combined population of USA, Indonesia, Brazil, Pakistan, Bangladesh and Japan (totalling 1214.3 million)! The absolute increase in India's population (181 million) during 2001–2011, is slightly lower than the population of Brazil, the fifth most populous country in the world!



Population of Selected Countries in 2010

Sl. No	*Country*	*Reference date*	*Population (in millions)*	*Decadal change (in %)*
1	China	01.11.2010	1,341.0	5.43
2	India	01.03 2011	1,210.2	17.64
3	U.S.A	01.04.2010	308.7	7.26
4	Indonesia	31.05.2010	237.6	15.05
5	Brazil	01.08.2010	190.7	9.39
6	Pakistan	01.07.2010	184.8	24.78
7	Bangladesh	01.07.2010	164.4	16.76
8	Nigeria	01.07.2010	158.3	26.84

9	Russian Fed.	01.07.2010	140.4	-4.29
10	Japan	01.10.2010	128.1	1.1
	Other Countries	01.07.2010	2844.7	15.43
	World	01.07.2010	6908.7	12.97

18 Facts about the Indian Population (Census- 2011)

1.	Total Population	–	1,210,193,422
2.	Density of Population	–	382 persons per sq. km.
3.	Highest Density	–	Bihar (1102 ppsq. km)
4.	Lowest Density	–	Arunachal Pradesh (17 ppsq. km)
5.	Sex Ratio	–	940/1000
6.	Highest Sex Ratio	–	Kerala (1084/1000)
7.	Lowest Sex Ratio	–	Haryana (877/1000)
8.	Male Literacy	–	82.10%
9.	Female Literacy	–	65.46%
10.	Literacy Rate (Nat. Av.)	–	74.04%
11.	Highest Lit. Rate	–	Kerala (93.91%)
12.	Lowest Lit. Rate	–	Bihar (63.82%)
13.	Highest Decadal Growth	–	Arunachal Pradesh (25.92%)
14.	Lowest Decadal Growth	–	Nagaaland (0.47%)
15.	Urban Population	–	30%
16.	Rural Population	–	70%
17.	Mega Cities	–	3
18.	Million Cities	–	53

Distribution of Population: Sex Ratio, Density and Decadal Growth (2011)

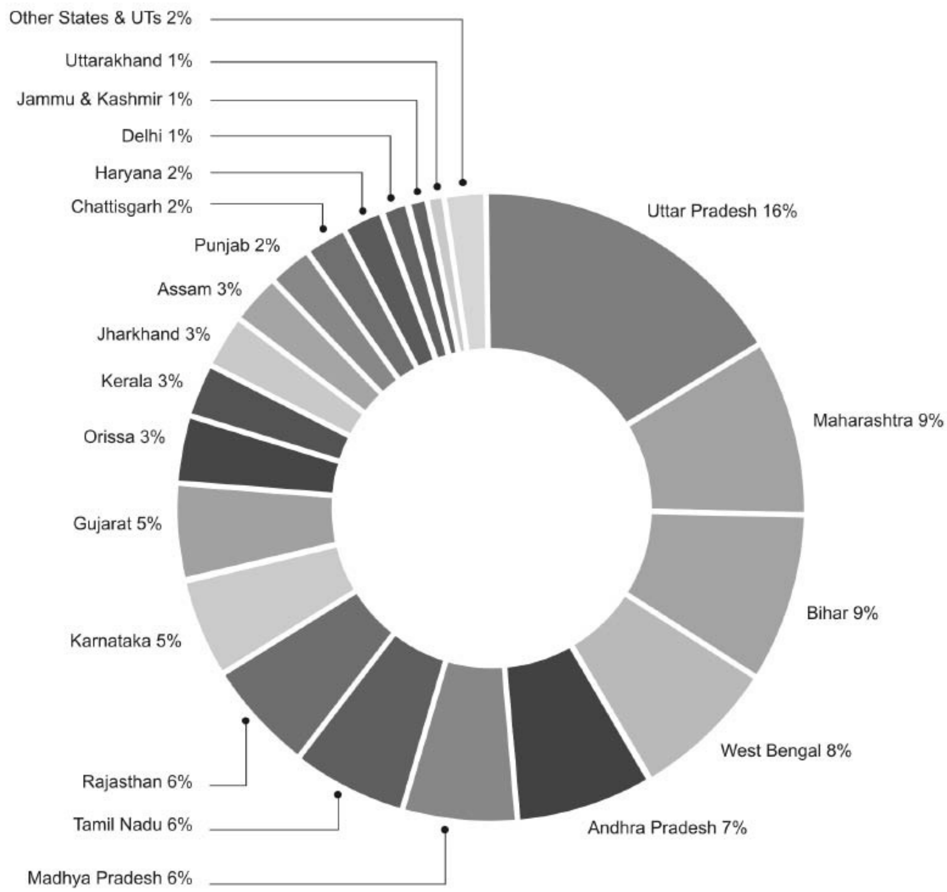
State /UT Code	*India/State/ Union * Territory*	*Total population Persons*	*Males*	*Females*	*Sex ratio (females per 1000 males)*	*Density (Per sq.km)*	*Decadal growth rate*
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**
	INDIA	**1.21.01.93.422**	**62.37.24.248**	**58,64.69.174**	**940**	**382**	**17.64**
01	Jammu & Kashmir	1.25.48.926	66.65.561	58.83.365	883	124	23.71
02	Himachal Pradesh	68.56.509	34.73.892	33,82.617	974	123	12.81
03	Punjab	2.77.04.236	1.46,34.819	1.30,69.417	893	550	13.73
04	Chandigarh*	10.54.686	5.80.282	4.74.404	818	9.252	17.10
05	Uttarakhand	1.01.16.752	51.54.178	49.62.574	963	189	19.17
06	Haryana	2.53.53.081	1.35.05.130	1.18.47.951	877	573	19.90
07	NQ of Delhi*	1.67.53.235	89.76.410	77.76,825	866	11.297	20.96
08	Rajasthan	6.86.21.012	3.56.20.086	3.30,00,926	926	201	21.44
09	Uttar Pradesh	19.95.81.477	10.45.96.415	9.49.85.062	908	828	20.09
10	Bihar	10.38.04.637	5.41.85.347	4.96.19,290	916	1.102	25.07

11	Sikkim	6.07.688	3.21.661	2.86.027	889	86	12.36
12	Arunachal Pradesh	13.82.611	7.20.232	6.62.379	920	17	25.92
13	Nagaland	19.80.602	10,25,707	9.54.895	931	119	–0.47
14	Man'pur	27.21.756	13.69,764	13.51.992	987	122	18.65
15	Mizoram	10.91.014	5.52.339	5.38.675	975	52	22.78
16	Tripura	36.71.032	18.71.867	17,99,165	961	350	14.75
17	Meghalaya	29.64.007	14,92.668	14,71.339	986	132	27.82
18	Assam	3.11.69.272	1,59.54.927	1.52.14.345	954	397	16.93
19	West Bengal	9.13.47.736	4,69.27.389	4,44,20.347	947	1,029	13.93
20	Jharkhand	3.29.66.238	1.69.31.688	1.60.34.550	947	414	22.34
21	Orissa	4.19.47.358	2.12.01,678	2.07,45.680	978	269	13.97
22	Chhattisgarh	2.55.40.196	1,28.27.915	1.27.12,281	991	189	22.59
23	Madhya Pradesh	7.25.97.565	3.76.12.920	3.49.84.645	930	236	20.30
24	Gujarat	6.03.83.628	3.14.82.282	2.89,01.346	918	308	19.17
25	Daman & Diu*	2.42.911	1.50.100	92.811	618	2,169	53.54
26	Dadra & Nagar Haveli*	3.42.853	1.93.178	1,49,675	775	698	55.50
27	Maharashtra	11.23.72.972	5.83.61.397	5.40.11.575	925	365	15.99
28	Andhra Pradesh	8.46.65.533	4.25.09.881	4.21,55,652	992	308	11.10
29	Kanataka	6.11.30.704	3,10.57.742	3.00.72,962	968	319	15.67
30	Goa	14.57.723	7.40.711	7,17.012	968	394	8.17
31	Lakshadweep[r]	64.429	33.106	31.323	946	2.013	623
32	Kerala	3.33.87.677	1,60.21.290	1.73.66.387	1.084	859	4.86
33	Tamil Nadu	7.21.38.958	3.61.58.871	3.59.80.087	995	555	15.60
34	Puducherry*	12.44.464	6.10.485	6.33.979	1,038	2.598	27.72
35	Andaman & Nicobar Islands*	3.79.944	2.02.330	1,77.614	878	46	6.68

Population Ranks of States: 2001–2011

Rank in 2011	*India/State/Union Territory#*	*Population 2011*	*Percent to total population of*		*Rank in 2001*
			20011	*2001*	
1	2	3	4	5	6
	INDIA	**1,21,01,93,422**	**100.00**	**100.00**	
1	Uttar Pradesh	19,95,81,477	16.49	16.16	1
2	Maharashtra	11,23,72,972	9.29	9.42	2
3	Bihar	10,38,04,637	8.58	8.07	3
4	West Bengal	9,13,47,736	7.55	7.79	4
5	Andhra Pradesh	8,46,65,533	7.00	7.41	5
6	Madhya Pradesh	7,25,97,565	6.00	5.87	7
7	Tamil Nadu	7,21,38,958	5.96	6.07	6
8	Rajasthan	6,86,21,012	5.67	5.49	8

9	Karnataka	6,11,30,704	5.05	5.14	9
10	Gujarat	6,03,83,628	4.99	4.93	10
11	Orissa	4,19,47,358	3.47	3.58	11
12	Kerala	3,33,87,677	2.76	3.10	12
13	Jharkhand	3,29,66,238	2.72	2.62	13
14	Assam	3,11,69,272	2.58	2.59	14
15	Punjab	2,77,04,236	2.29	2.37	15
16	Chhattisgarh	2.55,40,196	2.11	2.03	17
17	Haryana	2,53,53,081	2.09	2.06	16
18	NCT of Delhi#	1,67,53,235	1.38	1.35	18
19	Jammu & Kashmir	1,25,48,926	1.04	0.99	19
20	Uttarakhand	1,01,16,752	0.84	0.83	20
21	Himachal Pradesh	68,56,509	0.57	0.59	21
22	Tripura	36,71,032	0.30	0.31	22
23	Meghalaya	29,64,007	0.24	0.23	23
24	Manipur	27,21,756	0.22	0.22	24
25	Nagaland	19,80,602	0.16	0.19	25
26	Goa	14,57,723	0.12	0.13	26
27	Arunachal Pradesh	13,82,611	0.11	0.11	27
28	Punducherry#	12,44,464	0.10	0.09	28
29	Mizoram	10,91,014	0.09	0.09	29
30	Chandigarh#	10,54,686	0.09	0.09	30
31	Sikkim	6,07,688	0.05	0.05	31
32	Andaman & Nicobar Islands#	3,79,944	0.03	0.03	32
33	Dadra & Nagar Haveli#	3,42,853	0.03	0.02	33
34	Daman & Diu#	2,42,911	0.02	0.02	34
35	Lakshadweep#	64,429	0.01	0.01	35



Shares of States and UTs in Total Population

Sex Ratio of the Selected Countries

SI. No	*Country*	*2001*	*2011*
1	*2*	*2*	*3*
	World	**986**	**984**
1	China	944	926
2	India	933	940
3	U.S.A.	1,029	1,025
4	Indonesia	1,004	988
5	Brazil	1,025	1,042
6	Pakistan	938	943
7	Russian Fed.	1,140	1,167
8	Bangladesh	958	978
9	Japan	1,041	1,055
10	Nigeria	1.016	987

Sex Ratio: India & Neighbours

India among its neighbours 2001-2011

Countries	*2001*	*2011*
India	**933**	**940**
China	944	926
Pakistan	938	943

Bangladesh	958	978
Sri Lanka	1010	1034
Nepal	1005	1014
Afghanistan	930	931
Bhutan	919	897
Myanmar	1011	1048

India's Sex Ratio: 1901–2011

Census Year	*Sex ratio (Females per 1000 males)*
1	2
1901	972
1911	964
1921	955
1931	950
1941	945
1951	946
1961	941
1971	930
1981	934
1991	927
2001	933
2011	940

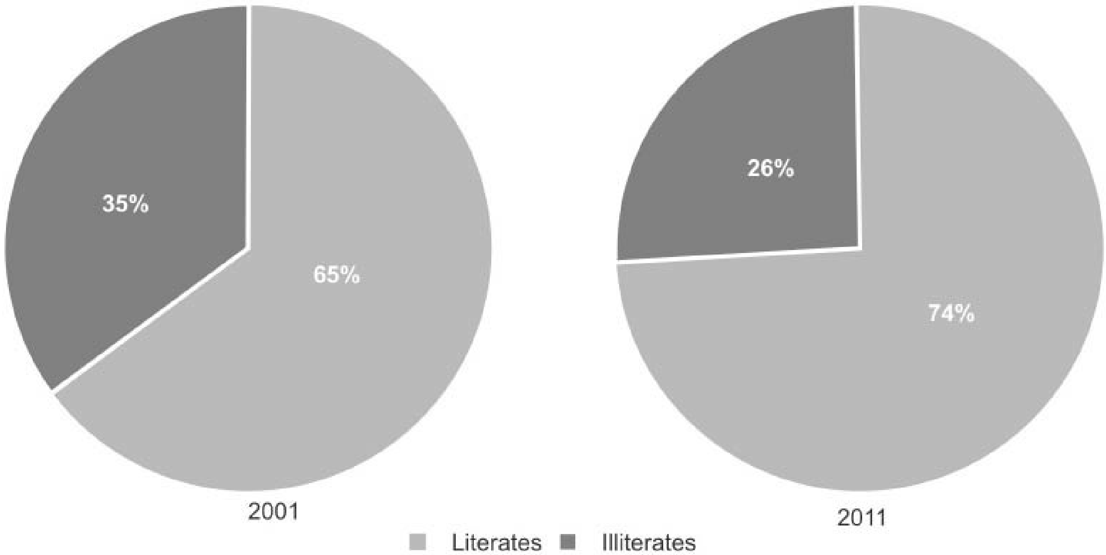
Sex Ratio of total population and child population in the age group 0-6 and above 7+ years: 2001-2011

State/ UT Code	*India/States/Union Territory#*	*Sex ratio (females per 1,000 males)*					
		Total population		*Child population in the age group 0-6*		*Population aged 7 and above*	
		2001	2011	2001	2011	2001	2011
1	2	3	4	5	6	7	8
	INDIA	**933**	**940**	**927**	**914**	**934**	**944**
01	Jammu & Kashmir	892	883	941	859	884	887
02	Himachal Pradesh	968	974	896	906	980	983
03	Punjab	876	893	798	846	888	899
04	Chandigarh#	777	818	845	867	767	812
05	Uttarakhand	962	963	908	886	973	975
06	Haryana	861	877	819	830	869	885
07	NCT of Delhi#	821	866	868	866	813	866

08	Rajasthan	921	926	909	883	923	935
09	Uttar Pradesh	898	908	916	899	894	910
10	Bihar	919	916	942	933	914	912
11	Sikkim	875	889	963	944	861	883
12	Arunachal Pradesh	893	920	964	960	878	913
13	Nagaland	900	931	964	944	890	929
14	Manipur	974	987	957	934	977	995
15	Mizoram	935	975	964	971	930	976
16	Tripura	948	961	966	953	945	962
17	Meghalaya	972	986	973	970	971	989
18	Assam	935	954	965	957	929	953
19	West Bengal	934	947	960	950	929	946
20	Jharkhand	941	947	965	943	935	948
21	Orissa	972	978	953	934	975	985
22	Chhattisgarh	989	991	975	964	992	995
23	Madhya Pradesh	919	930	932	912	916	933
24	Gujarat	920	918	883	886	927	923
25	Daman & Diu#	710	618	926	909	682	589
26	Dadra & Nagar Haveli#	812	775	979	924	779	752
27	Maharashtra	922	925	913	883	924	931
28	Andhra Pradesh	978	992	961	943	981	997
29	Karnataka	965	968	946	943	968	971
30	Goa	961	968	938	920	964	973
31	Lakshadweep#	948	946	959	908	946	951
32	Kerala	1,058	1,084	960	959	1,072	1,099
33	Tamil Nadu	978	995	942	946	993	1,000
34	Puducherry#	1,001	1,038	967	965	1,006	1,047
35	Andaman & Nicobar Islands#	846	878	957	966	831	868

Literacy Rate: 1951-2011

Census Year	*Persons*	*Males*	*Females*	*Male-Female gap in literacy rate*
1	**2**	**3**	**4**	**5**
1951	18.33	27.16	8.86	18.30
1961	28.3	40.4	15.35	25.05
1971	34.45	45.96	21.97	23.98
1981	43.57	56.38	29.76	26.62
1991	52.21	64.13	39.29	24.84
2001	64.83	75.26	53.67	21.59
2011	74.04	82.14	65.46	16.68



Shares of Literates & Illiterates: 2001-2011

Literacy, 2011: Ranking of States and UTs

Rank	*Persons* *India/State/ Union Territory#*	*Literacy rate*
1	**2**	**3**
1	Kerala	93.91
2	Lakshadweep#	92.28
3	Mizoram	91.58
4	Tripura	87.75
5	Qoa	87.40
6	Daman & Diu#	87.07
7	Puducherry#	86.55
8	Chandigarh#	86.43
9	NCT of Delhi#	86.34
10	Andaman & Nicobar Islands#	86.27
11	Himachal Pradesh	83.78
12	Maharashtra	82.91
13	Sikkim	82.20
14	Tamil Nadu	80.33
15	Nagaland	80.11
16	Manipur	79.85
17	Uttarakhand	79.63
18	Gujarat	79.31
19	Dadra & Naqar Haveli#	77.65
20	West Bengal	77.08
21	Punjab	76.68

22	Haryana	76.64
23	Karnataka	75.60
24	Meghalaya	75.48
25	Orissa	73.45
26	Assam	73.18
27	Chhattisgarh	71.04
28	Madhya Pradesh	70.63
29	Uttar Pradesh	69.72
30	Jammu & Kashmir	68.74
31	Andhra Pradesh	67.66
32	Jharkhand	67.63
33	Rajasthan	67.06
34	Arunachal Pradesh	66.95
35	Bihar	63.82

India: Density of Population (1901–2011)

Census Year	*Density (Per.sq.km)*	*Absolute Increase*	*%age Inaease*
1	2	3	4
1901	77		
1911	82	5	6.5
1921	81	-1	-U
1931	90	9	11.1
1941	103	13	14.4
1951	117	14	13.6
1961	142	25	21.4
1971	1771	35	24.6
1981	2162	39	22
1991	2672	51	23.6
2001	3252	58	21.7
2011	3822	57	17.5

UTs of India: Density Ranking (2001–2011)

Rank in 2011	*Union Territories#*	*Density (per sq.km)*		*Rank in 2001*
		2011	*2001*	
(1)	*(2)*	*(3)*	*(4)*	
	INDIA	**382**	**325**	
1	NCTof Delhi #	11297	9340	1
2	Chandigarh #	9252	7900	2
3	Puducherry #	2598	2034	3
4	Daman & Diu #	2169	1413	4

5	Lakshadweep #	2013	1895	5
6	Dadra & Nagar Haveli #	698	449	6
7	Andaman & Nicobar Islands #	46	43	7

Density Ranking of States: Comparative Study (2011–2011)

Rank in 2011	*States/Union Territory#*	*Density (per sq.km)*	*Rank in 2001*	
		2011	*2001*	
1	*2*	*3*	*4*	*5*
	INDIA	**382**	**325**	
1	NCT of Delhi #	11,297	9.340	1
2	Chandigarh #	9,252	7.900	2
3	Puducherry #	2.598	2.034	3
4	Daman & Diu #	2.169	1.413	5
5	Lakshadweep #	2.013	1.895	4
6	Bihar	1.102	881	7
7	West Bengal	1.029	903	6
8	Kerala	859	819	8
9	Uttar Pradesh	828	690	9
10	Dadra & Nagar Haveii #	698	449	13
11	Haryana	573	478	12
12	Tamil Nadu	555	480	11
13	Punjab	550	484	10
14	Jharkhand	414	338	16
15	Assam	397	340	15
16	Goa	394	364	14
18	Tripura	350	305	18
17	Maharashtra	365	315	17
19	Karnataka	319	276	20
20	Andhra Pradesh	308	277	19
21	Gujarat	308	258	21
22	Orissa	269	236	22
23	Madhya Pradesh	236	196	23
24	Rajasthan	201	165	24
25	Uttarakhand	189	159	25
26	Chhattisgarh	189	154	26
27	Meghalaya	132	103	29
28	Jammu & Kashmir	124	100	31
29	Himachal Pradesh	123	109	28
30	Manipur	122	103	30
31	Nagaland	119	120	27

32	Sikkim	86	76	32
33	Mizoram	52	42	34
34	Andaman & Nicobar Islands #	46	43	33
35	Arunachal Pradesh	17	13	35

(***Note:*** The information put here has been taken from the website of the *Office of the Registrar General & Census Commissioner, India*, Ministry of Home Affairs, GoI, N. Delhi. Tips and analyses have been added up by the author. Only that information of the *Census–2011* has been included which is useful from the examination point-of-view.)